SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1956

No. 64

LIBSON SHOPS, INC., PETITIONER,

vs.

GUSTAVE F. KOEHLER, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

INDEX

	Original	Print
Record from the United States District Court for the Eastern District of Missouri	1	1
Complaint	1	1
Exhibit A, Claim of Libson Shops, Inc., for Refund	7	6
Answer	13	11
Stipulation of Facts	14	13
Exhibit 1, Agreement for Statutory Merger of Various Libson Corporations into Libson Shops, Inc., Effective August 1, 1949	21	18
Exhibit 2, Copy of Certificate of Merger and Amendment issued by Secretary of State, State of Missouri, August 1, 1949	34	30
Exhibit 3, Copy of Certificate of Merger issued by Secretary of State, State of Illinois, August 1, 1949	35	31
Memorandum of United States District Judge	36	32
Findings of Fact	36	33
Conclusions of Law	36	33

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., AUG. 14, 1956

—774-0

	Original	Print
Record from the United States District Court for the Eastern District of Missouri—Continued		
Judgment, April 15, 1955	46	43
Notice of Appeal	47	43
Stipulation of Contents of Record on Appeal	47	44
Statement of Points on Appeal	48	45
Statement of Docket Entries	49	45
Proceedings in the United States Court of Appeals for the Eighth Circuit	51	47
Opinion; Vogel, J.	51	47
Judgment	67	61
Note re petition for rehearing (petition omitted in printing)	68	
Order denying petition for rehearing	69	61
Order staying issuance of mandate (omitted in printing)	70	
Clerk's certificate (omitted in printing)	71	
Order allowing certiorari	72	62

[fol. 1] [File endorsement omitted]

IN THE DISTRICT COURT OF THE UNITED STATES, FOR THE EASTERN DIVISION OF THE EASTERN JUDICIAL DISTRICT OF MISSOURI

Civil Action No. 9722 (2)

LIBSON SHOPS, INC., A CORPORATION, Plaintiff

v.

GUSTAVE F. KOEHLER, Defendant

COMPLAINT—Filed April 2, 1954

Comes now the plaintiff and for its cause of action against defendant states:

1. Plaintiff is a corporation duly organized and existing under and by virtue of the laws of the State of Missouri, with its principal office at 1209 Washington Avenue, St. Louis 3, Missouri.

2. The defendant is the District Director of Internal Revenue for the District of St. Louis, Missouri, having taken office as such on or about November 18, 1952, and is a resident of the Eastern Division of the Eastern Judicial District of Missouri.

3. This is an action to recover the sum of $12,988.84 in federal income taxes and interest thereon erroneously collected by defendant, together with interest on said sum from the date of payment thereof. It arises under the Internal Revenue Code of 1939, as amended, Title 26, United States Code, and this court has jurisdiction thereof under Title 28, Section 1340 of the United States Code.

4. On or about October 15, 1950 the plaintiff filed its federal income tax return for its taxable year ending July 31, 1950 with the Collector of Internal Revenue for the First District of Missouri, and paid the amount of tax shown to be due according to the return so filed.

5. Under date of April 1, 1952, the Internal Revenue Agent in Charge, St. Louis, Missouri, mailed to the plaintiff notice of a proposed deficiency in federal income tax for the plaintiff's taxable year ending July 31, 1950, in

the amount of $12,589.86. Subsequently the alleged deficiency was reduced to $12,392.83.

[fol. 2] 6. Said alleged deficiency in tax resulted from the disallowance by the Commissioner of Internal Revenue of certain deductions from gross income taken by the plaintiff in computing its net income in its said return for its taxable year ending July 1, 1950, to-wit: (a) $22,432.76 deducted as a net operating loss under Sections 23 (s) and 122 (b) (2) (C) of the Internal Revenue Code of 1939, as amended; and (b) $2,873.61 deducted as ordinary and necessary business expenses under Section 23 (a) (1) of the Code.

7. The relevant facts with respect to said deduction in the amount of $22,432.76 are as follows:

(a) The corporations listed below were each duly incorporated under the laws of the states and on the dates indicated:

Name	State of Incorporation	Date of Incorporation
Libson Shops Management Corporation	Missouri	January 2, 1946
Grand Libson Shops, Inc.	Missouri	January 2, 1946
Washington Libson Shops, Inc.	Missouri	January 2, 1946
Cape Girardeau Libson Shops, Inc.	Missouri	January 2, 1946
Arcade Libson Shops, Inc.	Missouri	January 2, 1946
Olive Libson Shops, Inc.	Missouri	January 2, 1946
Columbia Libson Shops, Inc.	Missouri	January 2, 1946
Maplewood Libson Shops, Inc.	Missouri	January 2, 1946
University City Libson Shops, Inc.	Missouri	January 2, 1946
Wellston Libson Shops, Inc.	Missouri	January 2, 1946
Cherokee Libson Shops, Inc.	Missouri	January 2, 1946
Gravois Libson Shops, Inc.	Missouri	January 8, 1946
Belleville Libson Shops, Inc.	Illinois	January 2, 1946
Oak Park Libson Shops, Inc.	Illinois	January 2, 1946
Evanston Libson Shops, Inc.	Illinois	January 2, 1946
Lawrence Libson Shops, Inc.	Illinois	January 2, 1946
Hampton Libson Shops, Inc.	Missouri	May 28, 1948

[fol. 3] (b) After their incorporation and prior to August 1, 1949, all of the issued and outstanding capital stock of each of said corporations except the said Hampton Libson Shops, Inc. was owned by eight individual stockholders. After its incorporation and prior to August 1, 1949, all of the issued and outstanding capital stock of Hampton Libson Shops, Inc. was owned by the said Cape Girardeau Libson Shops, Inc.

(c) Each of said corporations except Libson Shops Management Corporation was formed for the purpose of engaging in the business of retail selling of women's wearing

apparel; Libson Shops Management Corporation was formed for the purpose of providing management services for each of the other said corporations.

(d) Effective August 1, 1949, the said corporations entered into a written Agreement for Statutory Merger, and thereupon merged under and in accordance with the laws of the States of Missouri and Illinois.

(e) Under said Merger Agreement, Libson Shops Management Corporation, with its name changed to Libson Shops, Inc., plaintiff herein, is the surviving corporation.

(f) Under said Agreement, the outstanding shares of the capital stock of each of the constituent corporations in said merger, including plaintiff, became shares of the capital stock of plaintiff and certificates for such shares of the capital stock of plaintiff were issued to each of the said eight individual stockholders in lieu of their certificates in the said constitutent corporations.

(g) Article Seventh of said Agreement reads in part as follows:

> "Upon this Merger becoming effective, the Surviving Corporation shall have all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under the General and Business Corporation Act of Missouri; and all property, real, personal and mixed, and all debts due on whatever account, including subscriptions to shares, and all other choses in action, and all and every other interest of or belonging to or due to each of the corporations so merged or consolidated shall be taken and deemed to be transferred to and vested in such Surviving Corporation without further act or [fol. 4] deed; and the title to any real estate or any interest therein under the laws of Missouri vested in any of such Missouri corporations, and the title to any real estate or interest therein under the laws of Illinois vested in any of such Illinois corporations, shall not revert or be in any way impaired by reason of such merger; provided, however, that all rights of creditors and all liens upon any property of any of said Constitutent Corporations shall be preserved unimpaired, and all debts, liabilities, and duties of the respective

Constitutent Corporations shall thenceforth attach to said Surviving Corporation and may be enforced against it to the same extent as if said liabilities and duties had been incurred or contracted by it."

(h) Prior to their merger, the following of said merged corporations had sustained net operating losses for their taxable years in the amounts indicated below:

Corporation	Taxable Period	Amount
Evanston Libson Shops, Inc.	Calendar year 1948	$ 8,115.11
	January 1, 1949 to July 31, 1949	6,442.28
Lawrence Libson Shops, Inc.	January 1, 1948 to July 31, 1948	245.03
	Taxable year ended July 31, 1949	2,770.42
Hampton Libson Shops, Inc.	Taxable year ended July 31, 1949	4,879.92
Total		$22,432.76

8. The Commissioner disallowed the deduction of said net operating loss in the amount of $22,432.76. The disallowance of said deduction was erroneous.

9. The relevant facts with respect to said deduction in the amount of $2,873.61 are as follows:

(a) Of said amount of $2,873.61, $2,500 represented legal fees paid by the plaintiff on or about August 10, 1949, to the firm of Lowenhaupt, Waite, Chasnoff & Stolar for services hereafter described, and $195.56 represented taxes and fees in the nature of taxes paid by the plaintiff on various dates in July and August, 1949, to the Secretaries of State of the States of Illinois and Missouri.

[fol. 5] (b) Of said $2,500 amount paid to Lowenhaupt, Waite, Chasnoff & Stolar, $1,000 was allocable to services in effecting said merger and $1,500 was allocable to services in considering and advising upon several alternative plans for effecting the reorganization of the plaintiff and the other corporations above mentioned. In accordance with the final recommendations of its said attorneys, the plaintiff ultimately abandoned the said alternative plans of reorganization.

(c) The said taxes and the services for which said fees in the nature of taxes were charged, and the respective amounts thereof, were as follows:

Illinois

Item	Amount
Issuing license to do business	$ 35.19
Filing Articles of Merger	20.00
Filing application for amended license	20.00
Filing certified copy of Certificate of Merger	20.00
Filing report incident to Merger	1.00
Franchise tax	11.44
License fee	12.48
Certifying copy of Articles of Merger	11.15
Missouri	
Certifying copy of Certificate of Incorporation, Articles of Incorporation, and Certificate of Authority to do Business	6.90
Filing Merger Agreement	3.00
Tax on Increase in Capital Stock	25.00
Certifying copies of Certificate of Merger and Merger Agreement	29.40
Total Illinois and Missouri	$195.56

10. The Commissioner disallowed the said deductions in the amount of $2,873.61. Of the amount paid to Lowenhaupt, Waite, Chasnoff & Stolar, $1,500 was ordinary and necessary expense, deductible as such, and the amount of $195.56 above mentioned was taxes paid and ordinary and [fol. 6] necessary expense, deductible as such. The disallowance of the said deductions was erroneous.

11. On June 5, 1953, pursuant to the defendants' notice and demand for payment, the plaintiff paid to the defendant the sum of $13,288.85, representing said alleged deficiency in tax for the year ending July 31, 1950, in the amount of $12,392.83, and interest thereon in the amount of $896.02.

12. On August 13, 1953, the plaintiff filed with the defendant a claim for a refund in the amount of (a) $12,988.84, of which $12,113.05 was claimed as the refundable portion of the alleged deficiency in tax theretofore paid and $875.79 was claimed as the refundable portion of the interest paid thereon, or (b) such greater amount as might be legally refundable, with interest in either case. A copy of said claim is hereto attached, marked "Exhibit A," and by reference made a part hereof.

13. Under date of March 16, 1954, the District Director of Internal Revenue mailed to the plaintiff notice of the disallowance of the plaintiff's said claim for refund in its entirety.

14. The disallowance of the plaintiff's said claim for refund was erroneous.

Wherefore, plaintiff prays judgment against the defendant in the amount of $12,988.84, together with interest thereon as allowed by law, and costs, and for such other and further relief as to the Court may seem just.

Abraham Lowenhaupt, William R. MacGreevy, Owen T. Armstrong, Attorneys for Plaintiff, 408 Olive Street, St. Louis 2, Mo.

Of Counsel: Lowenhaupt, Waite, Chasnoff & Stolar, 408 Olive Street, St. Louis 2, Missouri.

[fol. 7] Exhibit A.—Claim of Libson Shops, Inc., for Refund.

Form 848
U. S. Treasury Department
Internal Revenue Service
(Revised June 1951)

Claim Recorded

Claim
To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in, where required, the certificate on the back of this form.

[ ] Refund of Taxes Illegally, Erroneously, or Excessively Collected.
[ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
[ ] Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

Collector's Stamp
(Date received)
Received
Aug. 13 1953
43 Dir. Int. Rev.
St. Louis

Mar '51—
410003

Name of taxpayer or
(Type) purchaser of stamps: Libson Shops, Inc.
(or) Street address: 1209 Washington Blvd.
(Print) City, postal zone number, and State: St. Louis 3, Missouri.

1. District in which return (if any) was filed: First District of Missouri.

2. Period (if for tax reported on annual basis, prepare separate form for each taxable year) from: Aug. 1, 1949, to July 31, 1950.

3. Kind of tax: Income Tax (Normal Tax and Surtax).

4. Amount of assessment, $13,288.25; dates of payment, June 5, 1953.

5. Date stamps were purchased from the Government:

[fol. 8] 6. Amount to be refunded: Income Tax $12,113.05 & interest $875.79 $12,988.84*

7. Amount to be abated (not applicable to income, estate, or gift taxes) $

The claimant believes that this claim should be allowed for the following reasons:

See following riders attached hereto and made a part hereof:

Rider "A": Statement of Facts and Grounds Upon Which Refund is Claimed.

Rider "B": Schedule of Computation of Amount of Refund.

(Attach letter-size sheets if space is not sufficient)

I declare under the penalties of perjury that this claim (including any accompanying schedules and statements) has been examined by me and to the best of my knowledge and belief is true and correct.

Signed Libson Shops, Inc., By H. E. Lieberman,
H. E. Lieberman, President.

Dated Aug. 11, 1953

(See Instructions on Other Side)

* or such greater amount as may be legally refundable, with interest.

Rider "A"

Statement of Facts and Grounds
Upon Which Refund Is Claimed

The Internal Revenue Agent in Charge, St. Louis, Missouri, by letter dated April 1, 1952, advised taxpayer of a proposed deficiency in income tax for the year in question in the amount of $12,589.86. Subsequently the Assistant District Commissioner of Internal Revenue, by letter dated May 12, 1953, corrected the statement of the proposed deficiency by reducing the amount thereof to $12,392.83. Said deficiency was attributable to the disallowance of certain deductions comprised in part of the following items:

1. *$22,432.76.* On August 1, 1949, the following related corporations merged in accordance with and under the statutes of the State of Missouri:

[fol. 9] Libson Shops Management Corporation.
Grand Libson Shops, Inc.
Washington Libson Shops, Inc.
Cape Girardeau Libson Shops, Inc.
Arcade Libson Shops, Inc.
Olive Libson Shops, Inc.
Columbia Libson Shops, Inc.
Maplewood Libson Shops, Inc.
University City Libson Shops, Inc.
Wellston Libson Shops, Inc.
Cherokee Libson Shops, Inc.
Gravois Libson Shops, Inc.
Belleville Libson Shops, Inc.
Oak Park Libson Shops, Inc.
Evanston Libson Shops, Inc.
Lawrence Libson Shops, Inc.
Hampton Libson Shops, Inc.

Pursuant to the terms of the merger agreement, Libson Shops Management Corporation, with its name changed to Libson Shops, Inc., was the surviving corporation. Prior to the merger the following of said merged corporations had sustained net operating losses for the periods and in the amounts indicated as follows:

Corporation	Taxable Period	Amount
Evanston Libson Shops, Inc.	Calendar year 1948	$ 8,115 11
	January 1, 1949 to July 31, 1949	6,422 28
Lawrence Libson Shops, Inc.	January 1, 1948 to July 31, 1948	245 03
	Taxable year ended July 31, 1949	2,770 12
Hampton Libson Shops, Inc.	Taxable year ended July 31, 1949	4,879 92
Total		$22,432 76

Said total amount of $22,432.76 is a net operating loss of the taxpayer deductible under Sections 23(s) and 122 (b) (2) (C) of the Internal Revenue Code. *Stanton Brewery* v. *Commissioner of Internal Revenue*, 176 F. (2d) 573.

[fol. 10] 2. *$1,500.00.* During the taxable year in question the taxpayer paid legal fees in the aggregate amount of $2500 to the firm of Lowenhaupt, Waite, Chasnoff & Stolar, St. Louis Missouri, for services in connection with said statutory merger. Of this amount, $1500 was allocable to services in considering various alternative plans for effecting the reorganization of taxpayer and the other related corporations listed above, which alternative plans were rejected by taxpayer in accordance with the final recommendations of said counsel. The $1500 amount is an ordinary and necessary business expense deductible under Section 23 (a) (1) of the Internal Revenue Code. *Sibley, Landsay & Curr Co.*, 15 T. C. 106, acq. 1951—1 C. B. 3.

3. *$195.56.* Also during the taxable year in question and in connection with the said merger, taxpayer paid taxes and fees in the nature of taxes to the Secretaries of State of the States of Illinois and Missouri, as follows:

Item	Amount
Illinois	
Issuing license to do business	$ 35 19
Filing Articles of Merger	20 00
Filing application for amended license	20 00
Filing certified copy of Certificate of Merger	20 00
Filing report incident to merger	1 00
Franchise tax	11 44
License fee	12 48
Certified copy of Articles of Merger	11 15
Missouri	
Certified copy of Certificate of Incorporation, Articles of Incorporation, and Certificate of Authority to do Business	6 90
Filing Merger Agreement	3 00
Increase in Capital Stock	25 00
Certified copies of Certificate of Merger and Merger Agreement	29 40
Total Illinois and Missouri	$195 56

[fol. 11] The amount of $195.56 comprised taxes deductible under Section 23 (c) of the Internal Revenue Code. *Borg & Beck Company*, 24 B. T. A. 995.

Rider "B"

Schedule of Computation of Amount of Refund

Net income per return	$24,361.94	
Plus: deduction properly disallowed organization expense	1,178.05	$25,539.99
Less: additional contributions reported and now deductible as within 5% limitation		58.90
Corrected net income		$25,481.09

Tax Computation

Net income as corrected		$25,481.09
Less: dividends received credit 85% of $12.50		10.63
Balance		$25,470.46
Less: Net long-term capital gain		730.96
		$24,739.50

1949 Rates

Normal tax on $20,000.00	$ 3,300.00
Normal tax on $ 4,739.50 at 19%	900.51
Surtax on $24,739.50 at 6%	1,484.37
Partial Tax	$ 5,684.88
Add: 25% of $730.96	182.74
Tax at 1949 rates	$ 5,867.62

[fol. 12]

1950 Rates		
Normal tax on $24,739.50 at 25%	$ 6,184.88	
Add: 25% of $730.96	182.74	
Tax at 1950 rates	$ 6,367.62	
Proration of Taxes		
334/365 × $5,867.62	$ 5,369.27	
31/365 × $6,367.62	540.81	
Total Income Tax Liability	$ 5,910.08	
Refund Computation		
Income Tax Assessed:		
Original, Account No. Mar.-410003-1951	$ 5,632.97	
Abatement, April 18, 1951	2.67	
	$ 5,630.30	
Alleged deficiency assessed and paid June 5, 1953	12,392.83	
Total Income Tax and alleged deficiency paid	$18,023.13	
Less: Income Tax Liability	5,910.08	
Income Tax Refundable		$12,113.05
Interest on alleged deficiency paid June 5, 1953	$ 896.02	
Portion of interest attributable to refundable portion of alleged deficiency		
$\frac{12,113.05}{12,392.83} \times 896.02 =$		875.79
Total Income Tax and Interest Refundable		$12,988.84

[fol. 13] IN UNITED STATES DISTRICT COURT

[File endorsement omitted]

ANSWER—Filed June 2, 1954

Defendant, for its answer to the complaint filed herein:

1. Denies knowledge or information sufficient to form a belief with respect to the allegations contained in Paragraph 1, which allegations accordingly are denied.

2. Admits the allegations contained in Paragraph 2.

3. Admits the allegations contained in Paragraph 3, except for the allegation that the taxes and interest were erroneously collected, which allegation is denied.

4. Admits the allegations contained in Paragraph 4, except for the allegation that the tax was paid on October 15, which allegation is denied.

5. Admits the allegations contained in Paragraph 5.

6. Admits the alleged deficiency in tax resulted, in part, from the disallowance by the Commissioner of Internal Revenue of certain deductions from gross income taken by plaintiff in computing its net income on its return for the taxable year ending July 31, 1950, and admits that $22,432.76 was deducted as a claimed net operating loss under Sections 23 (s) and 122 (b) (2) (C) of the Internal Revenue Code and that $2,873.61 was deducted as claimed ordinary and necessary business expenses under Section 23 (a) (1) of the Code. The remaining allegations contained in Paragraph 6 are denied.

7. Denies knowledge or information sufficient to form a belief with respect to the allegations contained in Paragraph 7, which allegations accordingly are denied.

8. Admits the allegations contained in the first sentence of Paragraph 8. The remaining allegations contained in that paragraph are denied.

9. Denies knowledge or information sufficient to form a belief with respect to the allegations contained in Paragraph 9, which allegations accordingly are denied.

10. Admits the allegations contained in the first sentence of Paragraph 10. The remaining allegations contained in that paragraph are denied.

[fol. 14] 11. Admits the allegations contained in Paragraph 11, except for the allegation that payment was made on June 5, 1953, which allegation is denied.

12. Admits the allegations contained in the first sentence of Paragraph 12, and admits that Exhibit A, attached to the complaint, is a true and accurate copy of the claim for refund filed by plaintiff. The remaining allegations contained in that paragraph, including every statement and allegation in the claim for refund not specifically admitted herein, are denied.

13. Admits the allegations contained in Paragraph 13.

14. Denies the allegations contained in Paragraph 14.

Wherefore, defendant prays that the complaint be dismissed, with costs assessed against the plaintiff.

Harry Richards, United States Attorney, Attorney for the Defendant, Robert E. Brauer, Assistant United States Attorney.

Copy of the above and foregoing Answer mailed this 2nd day of June, 1954, to Lowenhaupt, Waite, Chasnoff & Stolar, 408 Olive Street, St. Louis 2, Missouri, attorneys for plaintiff.

Robert E. Brauer, Assistant United States Attorney.

IN UNITED STATES DISTRICT COURT

[File endorsement omitted]

STIPULATION OF FACTS—Filed January 3, 1955

It is hereby stipulated and agreed by and between the parties hereto, by their respective counsel, that for the purpose of this action the following facts shall be taken as true; provided, however, that this stipulation shall be without prejudice to the rights of either party to introduce other and further evidence not inconsistent with the facts herein stipulated to be taken as true; provided, further, that the parties hereto expressly reserve the right to [fol. 15] object to the introduction of evidence on the grounds of irrelevancy and immateriality of any facts contained herein.

1. The plaintiff is a corporation duly organized and existing under and by virtue of the laws of the State of Missouri, with its principal office at 1209 Washington Avenue, St. Louis 3, Missouri.

2. The defendant is the District Director of Internal Revenue for the District of St. Louis, Missouri. He took said office on or about November 18, 1952, and he is a resident of the Eastern Division of the Eastern Judicial District of Missouri.

3. This is an action to recover the sum of $12,988.84 in federal income taxes and interest thereon alleged by plaintiff to have been overpaid for the fiscal year ended July 31, 1950. The jurisdiction of this Court is invoked under the Internal Revenue Code of 1939, as amended, Title 26, United States Code, and under Title 28, Section 1340 of the United States Code.

4. On or about October 14, 1950, the plaintiff filed its

federal income tax return for its fiscal year ended July 31, 1950, with the Collector of Internal Revenue for the First District of Missouri, and thereafter paid the amount of tax reported thereon as due.

5. The Commissioner of Internal Revenue on May 21, 1953, timely assessed against plaintiff a deficiency in tax for the fiscal year ended July 31, 1950 in the amount of $12,392.83 plus interest thereon in the amount of $896.02. This sum of $13,288.85 was paid by plaintiff to the defendant on June 6, 1953.

6. This deficiency in tax resulted in part from the disallowance of certain deductions from gross income taken by plaintiff in computing its net income in its federal income tax return for the taxable year ended July 31, 1950. The deductions disallowed were (a) the sum of $22,432.76 deducted as a net operating loss under Sections 23 (a) and 122 (b) (2) (C) of the Internal Revenue Code of 1939, as amended and (b) the sum of $2,873.61 deducted as ordinary and necessary business expenses under Section 23 (a) (1) of the Code.

[fol. 16] 7. Immediately prior to August 1, 1949 there were in existence the seventeen corporations listed below, each having been duly incorporated under the laws of the states and on the dates indicated:

Name	State of Incorporation	Date of Incorporation
Libson Shops Management Corporation	Missouri	Jan. 2, 1946
Grand Libson Shops, Inc.	Missouri	Jan. 2, 1946
Washington Libson Shops, Inc.	Missouri	Jan. 2, 1946
Cape Girardeau Libson Shops, Inc.	Missouri	Jan. 2, 1946
Arcade Libson Shops, Inc.	Missouri	Jan. 2, 1946
Olive Libson Shops, Inc.	Missouri	Jan. 2, 1946
Columbia Libson Shops, Inc.	Missouri	Jan. 2, 1946
Maplewood Libson Shops, Inc.	Missouri	Jan. 2, 1946
University City Libson Shops, Inc.	Missouri	Jan. 2, 1946
Wellston Libson Shops, Inc.	Missouri	Jan. 2, 1946
Cherokee Lisbon Shops, Inc.	Missouri	Jan. 2, 1946
Gravois Libson Shops, Inc.	Missouri	Jan. 2, 1946
Belleville Libson Shops, Inc.	Illinois	Jan. 2, 1946
Oak Park Libson Shops, Inc.	Illinois	Jan. 2, 1946
Evanston Libson Shops, Inc.	Illinois	Jan. 2, 1946
Lawrence Libson Shops, Inc.	Illinois	Jan. 2, 1946
Hampton Libson Shops, Inc.	Missouri	May 28, 1948

8. Each of these corporations, except Libson Shops Management Corporation, engaged in the business of retail selling of women's wearing apparel. Libson Shops Management Corporation engaged in the business of provid-

ing management services for the other corporations. The charter of Libson Shops Management Corporation also authorized it to engage in the business of retail selling of women's apparel, but it did not so engage.

9. On July 28, 1949 each of the corporations named in paragraph 7, pursuant to due authorization and approval by their respective Boards of Directors and stockholders, [fol. 17] duly executed an Agreement For Statutory Merger. A true and correct conformed copy of this Agreement For Statutory Merger is attached hereto as Exhibit 1.

10. On August 1, 1949, the corporations filed this Agreement For Statutory Merger in the office of the Secretary of State of the State of Missouri and the Secretary issued a Certificate of Merger and Amendment pursuant to the provisions of Section 67 of "The General and Business Corporation Law of Missouri." A true and correct copy of this Certificate of Merger and Amendment is attached hereto as Exhibit 2.

11. On August 1, 1949, the corporations executed Articles of Merger and filed these Articles in the office of the Secretary of State of the State of Illinois. The Secretary issued a Certificate of Merger pursuant to the provisions of Sections 69 (a) and 66 of "The Business Corporation Act" of the State of Illinois. A true and correct copy of this Certificate of Merger is attached hereto as Exhibit 3.

12. Certified copies of said Certificates were filed for record with the appropriate public official in each city or county within which were located the registered offices of the various corporations named in Paragraph 7.

13. After their incorporation and prior to August 1, 1949, all of the issued and outstanding capital stock of each of said corporations, except the said Hampton Libson Shops, Inc., was owned by the same eight stockholders, to-wit: H. E. Lieberman, Sidney M. Dawidoff, B. Lieberman, Dorothy Lieberman, Hanna Dawidoff and Tillie Lieberman, each owning 14.05%, and Abe Lieberman and Ada Lieberman, each owning 7.85% of the stock of said corporations. After its incorporation and prior to August 1, 1949, all of the issued and outstanding capital stock of Hampton Libson Shops, Inc., was owned by the said Cape Girardeau Libson Shops, Inc.

Following the issuance of said Certificate of Merger and Amendment and said Certificate of Merger, in lieu of all outstanding stock of the constitutent corporations in said merger, including the plaintiff, there were issued to the said eight individual stockholders thereof shares of the [fol. 18] capital stock of the plaintiff in the respective numbers set forth on page 7 of said Agreement For Statutory Merger, and all other action described in Article Third: I. of said Agreement For Statutory Merger was carried out just as set forth therein.

14. Prior to August 1, 1949, Evanston Libson Shops, Inc. has filed its federal income tax returns on a calendar year basis. For the calendar year 1948, this corporation sustained a net operating loss in the amount of $8,115.11 and for the tax period begun January 1, 1949 and ended July 31, 1949, it sustained a net operating loss of $6,422.28.

15. Prior to August 1, 1949, Lawrence Libson Shops, Inc. had filed its federal income tax returns on a calendar year basis through 1947 and it thereafter filed its returns on the basis of a fiscal year ended July 31, 1948. This corporation sustained net operating losses in the amount of $1,174.47 for the calendar year 1947 and in the amount of $939.23 for the fiscal year period begun January 1, 1948 and ended July 31, 1948. All but $245.03 of these losses were carried back by this corporation to the calendar year 1946 to offset income earned by the corporation in that taxable year. This corporation sustained a further net operating loss in the amount of $2,770.42 in its fiscal year ended July 31, 1949.

16. Prior to August 1, 1949, Hampton Libson Shops, Inc. filed its federal income tax returns on the basis of a fiscal year ended July 31. This corporation sustained a net operating loss in the amount of $4,879.92 in its fiscal year ended July 31, 1949.

17. Prior to August 1, 1949, Libson Shops Management Corporation had filed its federal income tax returns on the basis of a fiscal year ended July 31.

18. Plaintiff, in its return for its fiscal year ended July 31, 1950 reported a net income, before deduction for a net operating loss carry-over, of $46,794.70. It claimed a deduction in the amount of $22,432.76 for net operating loss,

computed on the basis of unused net operating loss carry-over credits of three of the constitutent corporations in said merger from preceding tax periods as follows:

[fol. 19]

Corporation	Taxable Period	Amount
Evanston Libson Shops, Inc.	Calendar year 1948	$ 8,115.11
	Fiscal period begun Jan. 1, 1949, and ended July 31, 1949	6,422.28
Lawrence Libson Shops, Inc.	Fiscal period ended July 31, 1948	245.03
	Fiscal year ended July 31, 1949	2,770.42
Hampton Libson Shops, Inc.	Fiscal year ended July 31, 1949	4,879.92
Total		$22,432.76

19. After August 1, 1949 the palintiff maintained separate accounting records for the respective retail units theretofore operated by the separate corporations, other than Libson Shops Management Corporation, named in Paragraph 7 above. Said records show that the retail units formerly operated by the corporations listed in Paragraph 18 sustained net operating losses in plaintiff's fiscal year ended July 31, 1950, as follows:

Store	Formerly Operated by	Amount of Loss
East St. Louis, Ill.	Evanston Libson Shops, Inc.	$ 2,260.41
Lawrence, Ill.	Lawrence Libson Shops, Inc.	2,615.06
Hampton Ave., St. Louis, Mo.	Hampton Libson Shops, Inc.	6.15

20. On its tax return for the fiscal year ended July 31, 1950 plaintiff claimed deductions for ordinary and necessary business expenses in an amount that included the sum of $2,873.61. This sum had been paid by plaintiff on September 27, 1949 to Lowenhaupt, Waite, Chasnoff & Stolar, a law firm with offices in St. Louis, Missouri. Of this sum, $2,500 was paid for legal fees and $373.61 was paid to reimburse the law firm for expenses it had previously incurred on behalf of plaintiff.

21. The issues formed by the pleadings in this action include the deductibility of $1500 of said sum of $2500 and [fol. 20] the deductibility of $195.56 of said sum of $373.61. Deductibility of said sum of $195.56 is no longer an issue in this action.

22. On August 13, 1953, plaintiff duly filed a claim for refund, a true and correct copy of which is attached to the complaint in this action.

23. Under date of March 16, 1954, the Commissioner of Internal Revenue disallowed the claim for refund filed by plaintiff.

Further Stipulation.

It is stipulated that if the Court decides either or both of the two issues of this case for plaintiff, the parties will compute the amount of the judgment to be entered for plaintiff and will thereafter submit to the Court for approval the form of judgment to be entered.

Owen T. Armstrong, Attorney for Plaintiff, 408 Olive Street, St. Louis 2, Mo.

Of Counsel: Lowenhaupt, Mattingly, Chasnoff & Stolar, 408 Olive Street, St. Louis 2, Mo.

Jerome Fink, Counsel Trial Section, Tax Division, Department of Justice.

[fol. 21] Exhibit 1 to Stipulation

Agreement for Statutory Merger

of

Various Libson Corporations

into

Libson Shops, Inc.,

Formerly Libson Shops Management Corporation

(a Missouri Corporation).

Effective Date: August 1, 1949

Agreement for Statutory Merger

This Agreement for Statutory Merger (sometimes herein called "Merger Agreement") made at St. Louis, Missouri, on July 28th, 1949, by and among Libson Shops Management Corporation, a corporation duly created, organized, and existing under and by virtue of the laws of the State of Missouri and having its principal office in the City of

St. Louis, Missouri, at 1209 Washington Avenue, St. Louis 3, Missouri (hereinafter sometimes called "Surviving Corporation"), and the following corporations each duly created, organized, and existing under and by virtue of the laws of the State of Missouri: Grand Libson Shops, Inc., Gravis Libson Shops, Inc., Washington Libson Shops, Inc., Cape Girardeau Libson Shops, Inc., Arcade Libson Shops, Inc., Olive Libson Shops, Inc., Columbia Libson Shops, Inc., Maplewood Libson Shops, Inc., University City Libson Shops, Inc., Wellston Libson Shops, Inc., Cherokee Libson Shops, Inc., and Hampton Libson Shops, Inc., and the following corporations each duly created, organized and existing under and by virtue of the laws of the State of Illinois: Belleville Libson Shops, Inc., Oak Park Libson Shops, Inc., Lawrence Libson Shops, Inc., and Evanston Libson Shops, Inc. (each of which is hereinafter called a "Constituent Corporation" and together with said Surviving Corporation are called "the Constituent Corporations");

[fol. 22] Witnesseth;

That the respective parties hereto do hereby make the following recitals:

1. The Articles of Incorporation of Libson Shops Management Corporation were duly filed in the office of the Secretary of the State of Missouri on the 2nd day of January, 1946, and a Certificate of Incorporation thereon was issued by the Secretary of State on said date. Said Certificate of Incorporation showed the amount of the authorized shares of said corporation as $100,000, consisting of 500 shares of common stock of the par value of $100 per share and 500 shares of 4% cumulative preferred stock of the par value of $100 per share; that thereafter under date of January 8, 1946, a Certificate of Authority to Commence Business was duly issued to said corporation by the Secretary of State; that under date of April 19, 1946, there was filed in the office of the Secretary of State a Statement of Increase of Capital Stock increasing the authorized capital to 1,000 shares of common stock, par value $100 per share, and 500 shares of 4% cumulative preferred stock, par value $100 per share, and that on said date the Secre-

tary of State issued his Certificate of Amendment thereon; that none of said authorized preferred stock has ever been issued and that the number of shares of common stock heretofore issued and paid up and presently outstanding is 470 shares. On July 23rd, 1949, said corporation duly qualified as a foreign corporation under the Business Corporation Act of Illinois.

2. The Articles of Incorporation of each of the following corporations, to-wit: Grand Libson Shops, Inc., Washington Libson Shops, Inc., Cape Girardeau Libson Shops, Inc., Arcade Libson Shops, Inc., Olive Libson Shops, Inc., Columbia Libson Shops, Inc., Maplewood Libson Shops, Inc., University City Libson Shops, Inc., Wellston Libson Shops, Inc., and Cherokee Libson Shops, Inc., were duly filed in the office of the Secretary of State of Missouri on the 2nd day of January, 1946, and a Certificate of Incorporation was issued by the Secretary of State of Missouri to each of said corporations on the same day. On January 8, 1946, the Secretary of State of Missouri issued to [fol. 23] each of said corporations a Certificate of Authority to Commence Business.

3. The Articles of Incorporation of Gravois Libson Shops, Inc., were duly filed in the office of the Secretary of State of Missouri on the 8th day of January, 1946, and a Certificate of Incorporation was issued by the Secretary of State of Missouri on the same day. On January 17, 1946, the Secretary of State of Missouri issued to said corporation a Certificate of Authority to Commence Business.

4. The Articles of Incorporation of Hampton Libson Shops, Inc., were duly filed in the office of the Secretary of State of Missouri on the 28th day of May, 1948, and a Certificate of Incorporation was issued by the Secretary of State of Missouri on the same day. On June 4, 1948, the Secretary of State of Missouri issued to said corporation a Certificate of Authority to Commence Business.

5. Articles of Incorporation executed by the respective incorporators thereof with respect to the incorporation of each of the following corporations, to wit: Belleville Libson Shops, Inc., Oak Park Libson Shops, Inc., Evanston Libson Shops, Inc., and Lawrence Libson Shops, Inc., were

filed with the Secretary of State of Illinois on January 2, 1946, and a Certificate of Incorporation was duly issued thereon to each by the Secretary of State of the State of Illinois on the same day.

6. Each of the corporations above named was incorporated for a perpetual term and except in the case of Libson Shops Management Corporation each Certificate of Incorporation showed that the amount of the authorized shares was $50,000, consisting of 200 shares of common stock of the par value of $100 per share and 300 shares of 4% cumulative preferred stock of the par value of $100 per share, and upon incorporation each of said corporations (except as otherwise herein stated) issued 20 shares of common stock which was fully paid for. None of the authorized preferred stock of any of said corporations has ever been issued. No common stock of any of said corporations has been issued except as above set forth.

[fol. 24] 7. All of the issued and outstanding stock of each of said corporations, except stock of Hampton Libson Shops, Inc., is owned by the same eight stockholders, to-wit: H. E. Lieberman, Sidney M. Dawidoff, B. Lieberman, Dorothy Lieberman, Hanna Dawidoff and Tillie Lieberman, each owning 14.05%, and Abe Lieberman and Ada Lieberman, each owning 7.85% of the stock of each of said corporations. The issued and outstanding stock of Hampton Libson Shops, Inc., is wholly owned by Cape Girardeau Libson Shops, Inc., whose stock in turn is owned by said eight individuals in the proportions mentioned. Said eight individual stockholders constitute the Board of Directors of each of said corporations.

Now, Therefore, in consideration of the premises and of the mutual agreements, provisions, covenants and grants herein contained, the parties hereto hereby agree, according to the provisions of the General and Business Corporation Act of Missouri and also according to the Business Corporation Act of Illinois, that all of the Constituent Corporations other than Libson Shops Management Corporation shall be and are hereby merged into said Libson Shops Management Corporation, and that the terms and conditions of the merger hereby agreed upon and the mode of carrying the same into effect are as follows:

First: Libson Shops Management Corporation's corporate existence shall survive said merger and it shall continue as the surviving corporation under the name hereinafter specified. Said surviving corporation is hereinafter referred to as "Surviving Corporation" or as the "Corporation."

Second: The Certificate of Incorporation of the Surviving Corporation shall be and is hereby amended so that the following statements and provisions shall be applicable to it:

I. The name of the Corporation shall be Libson Shops, Inc.

II. The location of the principal and registered office of the Corporation in the State of Missouri is and shall be 1209 Washington Avenue, St. Louis 3, Missouri, and [fol. 25] the name of its registered agent is and shall be Sidney M. Dawidoff, whose address is the same as that of said principal and registered office.

III. The nature of the business of the Corporation and the objects and purposes to be transacted, promoted and carried on by the Corporation are as set forth in its Articles of Incorporation in Article Eighth thereof, amended to read as follows:

"Article Eighth

"The corporation is formed for the following purposes: To operate and maintain stores for the retail or wholesale sale of hosiery, women's wear and general wearing apparel; to vend, sell, buy, deal in and manufacture hosiery, women's wear and wearing apparel of every kind and description; to operate factories for the manufacture of hosiery, women's wear and wearing apparel; to apply for, acquire, own, buy, sell, assign, lease, pledge, mortgage or otherwise dispose of letters patent of the United States or of any foreign country and all of any rights, territorial or otherwise thereunder concerning hosiery, women's wear and wearing apparel, and the manufacture thereof; to apply for, acquire, hold, sell, assign, lease, mortgage or otherwise dispose of patent rights, licenses, privileges, inventions, trade-marks, trade names and pending applications therefor, relating to or useful in con-

nection with hosiery, women's wear and wearing apparel, and the manufacture thereof; to use, manufacture, or grant licenses, under any letters patent owned or controlled by the corporation, and to expend money in experimenting upon and testing the validity or value of any patent rights the corporation may acquire or propose to acquire, apply for, purchase or otherwise acquire, hold, own, use, operate, sell, assign, grant or conduct licenses in respect to any and all inventions, inmprovements and processes used in connection with or secured under letters patent of the United States or elsewhere, in connection with hosiery, women's wear and other wearing apparel, or the manufacture or sale thereof; to acquire and undertake all or any part of the business, assets, good will, prop-
[fol. 26] erty, and liabilities of any person, firm, association or corporation in connection therewith; to take, acquire, purchase, hold, own, rent, lease, sell, exchange, mortgage, improve, cultivate, develop and otherwise deal in and dispose of any and all property, real and personal of every description, incidental to or capable of being used in connection with the aforesaid businesses or any of them; to bororw money necessary for the prosecution of the business of the corporation, and to give security for the payment thereof; to lease, mortgage, plead, sell, convey or transfer such real or personal property as may be necessary for the transaction of the business of the corporation and to do all other things subsidiary, necessary or convenient for carrying out and into effect each and all of the aforesaid purposes and objects; and to do all things necessarily incident thereto.

"To purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise hold and possess or otherwise dispose of shares of capital stock or any bonds, securities or evidences of indebtedness created by any other corporation or corporations of this State or any other state, county, nation or government, and while the owner of said stock to exercise all the rights and powers and privileges of ownership, including the right to vote thereon.

"To purchase, hold, sell or transfer shares of its own capital stock provided it does not use its funds or property for the purchase of its own shares of stock when such use would cause an impairment of the capital of the corporation or perpetrate a fraud upon its creditors or other stockholders, and provided further that shares of its own capital stock belonging to the corporation shall not be voted upon by the corporation.

"To supervise, manage, advise, purchase for, and otherwise handle retail stores, corporations, or other units that may deal or engage in the above said business purposes.

"The objects and purposes specified as aforesaid shall be construed both as purposes and powers and [fol. 27] shall be in no wise limited or restricted by reference or inference from the terms of any other clause in this Article, but the objects and purposes specified in each of the foregoing clauses of this Article Eighth shall be regarded as independent objects, purposes and powers, and it is hereby expressly provided that any enumeration of specific powers shall not be held to limit or restrict in any manner the powers of the Corporation as generally expressed, nor shall the Corporation be required to exercise all of its powers at any one time."

IV. The total number of shares of stock which the Corporation shall have authority to issue is twenty thousand (20,000) shares, each share being of the par value of Ten Dollars ($10.00). All of said shares shall be of one class and shall be known as "Capital Stock." Shares of Capital Stock not required to be issued pursuant to the provisions of Articles Third and Fourth hereof may be issued for such consideration, not less than the par value thereof, as the Board of Directors may from time to time determine.

V. The term of existence of the Corporation shall be perpetual.

VI. The number of Directors who shall manage the affairs of the Corporation until other provision is made shall be eight (8).

VII. The Corporation reserves the right to amend, alter,

change or repeal any provision contained in its Certificate of Incorporation as amended from time to time in the manner now or hereafter prescribed by law, and all rights conferred upon stockholders therein are granted subject to this reservation.

Third: The outstanding shares of Capital Stock of the Constituent Corporations (including the Surviving Corporation) shall be converted into shares of Capital Stock of the Surviving Corporation as follows:

I. In lieu of all outstanding stock of the Constituent Corporations, including that of the Surviving Corporation, there shall be issued to the stockholders thereof who (as heretofore stated) each own stock in each Constitutent Cor- [fol. 28] poration (except in Hampton Libson Shops, Inc., which is a wholly owned subsidiary of Cape Girardeau Libson Shops, Inc.) 16,000 shares of capital stock of the Surviving Corporation. Said 16,000 shares shall be issued as follows:

To	H. E. Lieberman	2248 shares
	Sidney M. Dawidoff	2248 "
	B. Lieberman	2248 "
	Dorothy Lieberman	2248 "
	Hanna Dawidoff	2248 "
	Tillie Lieberman	2248 "
	Abe Lieberman	1256 "
	Ada Lieberman	1256 "

i. e., in the same proportion in which said persons now hold stock, directly or indirectly, as aforesaid in each of said corporations. Certificates representing such stock shall be delivered to said persons upon surrender by them to the Surviving Corporation of all certificates presently representing all of the outstanding capital stock of all of said corporations now held by said stockholders. Certificates for shares of stock in Hampton Libson Shops, Inc., shall be surrendered to the Surviving Corporation for cancellation without issuance to Cape Girardeau Libson Shops, Inc., the owner thereof, of any stock on account of the cancellation of the stock of said Hampton Libson Shops, Inc., inasmuch as said stock is an asset of its parent, Cape Girardeau Libson Shops, Inc., whose stockholders are to

share in the stock to be issued by the Surviving Corporation.

II. Four Thousand (4,000) shares of the Capital Stock of the Surviving Corporation shall presently remain authorized but unissued.

III. The shares of Capital Stock of the Surviving Corporation issued pursuant to this Article Third shall upon such issuance be fully paid and non-assessable, inasmuch as the net worth of the Constituent Corporations is substantially in excess of the aggregate par value of such shares. To the extent that the par value of stock to be issued as aforesaid is in excess of the par value of the [fol. 29] combined capital stock of the Constituent Corporations heretofore paid up and available therefor, such excess shall be paid up by transferring from Surplus Account of the Surviving Corporation to its Capital Account the amount necessary to pay up in full the capital stock of the Surviving Corporation so to be issued, the combined surplus of the Constituent Corporations being at this time in excess of the amount required for such purpose. As of the close of business July 31, 1948, the combined outstanding and paid up capital stock and the combined surplus of the Constituent Corporations as shown by the books of the company on a consolidated basis amounted to $229,380.90 and is the same at the present time except as affected by transactions in the ordinary course of business, which as a whole has been profitable and has resulted in a further increase in net worth.

IV. Upon proof satisfactory to the President and the Secretary (or, in their absence or disability, a Vice-President or Assistant Secretary, respectively) of the Surviving Corporation that any stock certificate otherwise required to be surrendered has been lost, stolen, or destroyed, and upon due application in writing by the person entitled thereto and the giving of an indemnity bond, satisfactory to the Treasurer of the Surviving Corporation, as to surety and conditions, the proper officers of the Surviving Corporation are authorized to cause a certificate or certificates representing the appropriate number of shares of Capital Stock of the Surviving Corporation to be issued without the surrender of the stock certificates alleged to have been lost, stolen, or destroyed.

Fourth: The names and post-office addresses of the Directors of the Corporation to serve upon such merger becoming effective and until their successors shall have been duly elected and shall qualify, are as follows:

H. E. Lieberman, 19 Thorndell Drive, Richmond Heights 17, Mo.
Sidney M. Dawidoff, 7548 Oxford Drive, Clayton 5, Mo.
B. Lieberman, 7548 Oxford Drive, Clayton 5, Mo.
Abe Lieberman, 7541 Parkdale Ave., Clayton 5, Mo.
[fol. 30] Dorothy Lieberman, 19 Thorndell Drive, Richmond Heights 17, Mo.
Hanna Dawidoff, 7548 Oxford Drive, Clayton 5, Mo.
Tillie Lieberman, 7548 Oxford Drive, Clayton 5, Mo.
Ada Lieberman, 7541 Parkdale Ave., Clayton 5, Mo.

and the names of the officers of the Corporation who shall hold office until their respective successors are chosen and have duly qualified, subject, however, to removal from office at any time by the Board of Directors, are:

H. E. Lieberman	President
Sidney M. Dawidoff	Sec.-Treas.
Abe Lieberman	Vice-President
Bernard Lieberman	Vice-President.

Fifth: The By-laws of the Corporation initially shall be those heretofore adopted by the Surviving Corporation as its By-laws and in effect at the date of this Merger Agreement.

Sixth: The Merger Agreement shall be submitted to the stockholders of each of said Constituent Corporations at separate meetings thereof called for the purpose of considering the same upon notice given in a manner sufficient to satisfy the requirements of both the State of Illinois and the State of Missouri. As soon as all statutory and other requirements which are conditions precedent to this Merger Agreement becoming legally effective have been complied with, this Merger Agreement and the Merger herein contemplated shall be and become effective, but if for any reason the effective date shall be delayed beyond July 31, 1949, then upon the same becoming effective the same shall

as between the parties hereto be treated as if it had become effective at the opening of business on August 1, 1949.

Seventh: Upon this Merger becoming effective, the Surviving Corporation shall have all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under the General and Business Corporation Act of Missouri; and [fol. 31] all property, real, personal and mixed, and all debts due on whatever account, including subscriptions to shares, and all other choses in action, and all and every other interest of or belonging to or due to each of the corporations so merged or consolidated shall be taken and deemed to be transferred to and vested in such Surviving Corporation without further act or deed; and the title to any real estate or any interest therein under the laws of Missouri vested in any of such Missouri corporations, and the title to any real estate or interest therein under the laws of Illinois vested in any of such Illinois corporations, shall not revert or be in any way impaired by reason of such merger; provided, however, that all rights of creditors and all liens upon any property of any of said Constitutent Corporations shall be preserved unimpaired, and all debts, liabilities, and duties of the respective Constitutent Corporations shall thenceforth attach to said Surviving Corporation and may be enforced against it to the same extent as if said liabilities and duties had been incurred or contracted by it. If at any time the Surviving Corporation shall conclude or be advised that any further assignments, assurances in the law, or things are necessary or desirable to vest in it the title to any property of any of the Constituent Corporations, its proper officers and directors shall and will execute all proper assignments and assurances in the law and do all things necessary or proper to vest title to such property in the Surviving Corporation, and otherwise to carry out the purposes of this Agreement. If in any case a separate conveyance or other instrument of assurance of title to the Surviving Corporation of any of the assets of the Constitutent Corporations shall be required in order to conform to local applicable laws, such conveyance or instrument may be executed in the name of one or more of the Constituent Corporations as of the

date on which this Merger became effective by the respective officers of such corporations in office at that time or subsequently appointed for such purpose by the Board of Directors of the Surviving Corporation.

Eighth: Upon this merger becoming effective, the amount of all surplus reserve accounts, Capital Stock Account, Capital Surplus Account, and Earned Surplus Account of [fol. 32] each of the Constituent Corporations shall be carried forward to the books of the Surviving Corporation as its surplus reserve accounts, Capital Stock Account, Capital Surplus Account, and Earned Surplus Account respectively, except that proper adjustment shall be made to reflect changes in Capital Stock Account arising out of issuance or conversion of stock as herein elsewhere provided, so that the aggregate amount of the net assets of the merging corporations which was available for the payment of dividends immediately prior to such merger or consolidation, to the extent that the value thereof is not required to be transferred to stated capital on account of the issuance of shares or otherwise, shall continue to be available for the payment of dividends by such Surviving Corporation.

Ninth: It is agreed that upon and after the issuance of a certificate of merger by the Secretary of State of the State of Illinois:

I. The Surviving Corporation may be served with process in the State of Illinois in any proceeding for the enforcement of any obligation of any corporation organized under the laws of the State of Illinois which is a party to the merger, and in any proceeding for the enforcement of the rights of a dissenting shareholder of any such corporation organized under the laws of the State of Illinois against the Surviving Corporation;

II. The Secretary of State of the State of Illinois shall be and hereby is irrevocably appointed as the agent of the Surviving Corporation to accept service of process in any such proceeding; and

III. The Surviving Corporation will promptly pay to the dissenting shareholders of any corporation organized under the laws of the State of Illinois which is a party to the merger the amount, if any, to which they shall be entitled

under the provisions of The Business Corporation Act of the State of Illinois with respect to the rights of dissenting shareholders.

In Witness Whereof, the corporations parties hereto have each caused these presents to be executed on the day and year first above written by their respective Directors and [fol. 33] their respective corporate seals to be affixed hereto and attested by their respective Secretaries.

Libson Shops Management Corporation, Grand Libson Shops, Inc., Gravois Libson Shops, Inc., Washington Libson Shops, Inc., Cape Girardeau Libson Shops, Inc., Arcade Libson Shops, Inc., Olive Libson Shops, Inc., Columbia Libson Shops, Inc., Maplewood Libson Shops, Inc., University City Libson Shops, Inc., Wellston Libson Shops, Inc., Cherokee Libson Shops, Inc., Hampton Libson Shops, Inc., Belleville Libson Shops, Inc., Oak Park Libson Shops, Inc., Lawrence Libson Shops, Inc., Evanston Libson Shops, Inc.

Each by its Directors, said Directors of each being:

H. E. Lieberman, Sidney M. Dawidoff, B. Lieberman, Abe Lieberman, Dorothy Lieberman, Hanna Dawidoff Tillie Lieberman, Ada Lieberman.

* * * * * * *

[fol. 34] EXHIBIT 2 TO STIPULATION

State of Missouri

Certificate of Merger and Amendment

(Seal of State of Missouri)

To All to Whom These Presents Shall Come:

I, Walter H. Toberman, Secretary of State of the State of Missouri, and Keeper of the Great Seal thereof, do hereby certify that Grand Libson Shops, Inc., Gravois Libson Shops, Inc., Washington Libson Shops, Inc., Cape Girardeau Libson Shops, Inc., Arcade Libson Shops, Inc., Olive Libson Shops, Inc., Columbia Libson Shops, Inc.,

Maplewood Libson Shops, Inc., University City Libson Shops, Inc., Wellston Libson Shops, Inc., Cherokee Libson Shops, Inc., and Hampton Libson Shops, Inc., corporations organized under the Laws of Missouri, have filed in the Office of the Secretary of State their Certificate of Merger into Libson Shops Management Corporation, Survivor. The surviving corporation also amends the Articles of Incorporation as follows:

1) Change of Name to Libson Shops, Inc.;
2) Changing and Increasing authorized shares
From: 1,000 shares Common Stock par value $100.00 per share
20,000 shares Common Stock par value $100.00 per share

3) Extending business purposes

as provided by Law, and have in all respects complied with the requirements of law governing the Merger and Amendment of corporations organized under The General and Business Corporation Act of Missouri.

In Witness Whereof, I hereunto set my hand and affix the Great Seal of the State of Missouri. Done at the City of Jefferson, this 1st day of August, A. D. 1949.

Walter H. Toberman, Secretary of State. J. Paul Markway, Chief Clark. (Seal).

[fol. 35] EXHIBIT 3 TO STIPULATION

Book 1954, Page 158

Certificate Number 172

State of Illinois

Office of the Secretary of State

(Seal of State of Illinois)

To All to Whom These Presents Shall Come, Greetings:

Whereas, Articles of Merger duly signed and verified of Grand Libson Shops, Inc., Gravois Libson Shops, Inc., Washington Libson Shops, Inc., Cape Girardeau Libson

Shops, Inc., Arcade Libson Shops, Inc., Olive Libson Shops, Inc., Columbia Libson Shops, Inc., Maplewood Libson Shops, Inc., University City Libson Shops, Inc., Wellston Libson Shops, Inc., Cherokee Libson Shops, Inc., and Hampton Libson Shops, Inc. (all Missouri corporations), merged with Beleville Libson Shops, Inc., Oak Park Libson Shops, Inc., Lawrence Libson Shops, Inc. and Evanston Libson Shops, Inc. (all Illinois corporations), into Libson Shops Management Corporation (a. Missouri corporation), have been filed in the Office of the Secretary of State on the 1st day of August, A. D. 1949, as provided by "The Business Corporation Act" of Illinois, in force July 13, A. D. 1933, as amended: Now Therefore, I, Edward J. Barrett, Secretary of State of the State of Illinois, by virtue of the powers vested in me by law, do hereby issue this certificate of merger and attach thereto a copy of the Articles of Merger of the aforesaid corporation.

In Testimony Whereof, I hereto set my hand and cause to be affixed the Great Seal of the State of Illinois. Done at the City of Springfield this 1st day of August, A. D. 1949, and of the Independence of the United States the one hundred and 74th.

Edward J. Barrett, Secretary of State. (Seal.)

MEMORANDUM—March 23, 1955

[fol. 36] IN UNITED STATES DISTRICT COURT

This is a suit for a tax refund. Two issues are presented: (1) whether a surviving corporation in a statutory merger, in computing its net income after the merger, is entitled to carry over and deduct net operating losses sustained by 3 of the 17 merged corporations, prior to the merger, under the provisions of 26 U. S. C. § 122 (b) (2) (C) (1952); and (2) whether attorney's fees for service in such a reorganization proceeding are a deductible item or must they be capitalized.

I

Findings of Fact

The first question is presented on a "Stipulation of Facts". Stipulated facts, as in paragraphs 1 to 23, are by reference here adopted.

Conclusions of Law

Plaintiff relies on the case of Stanton Brewery v. Commissioner of Internal Revenue (2d Cir.), 176 F. 2d 573, to sustain its right to a loss carry-over. This case is persuasive authority for plaintiff. There are some differences. Here we are concerned with a corporation operating-loss. In the Stanton case the Court was concerned with "unused excess profits carry-back and carry-over". The Court in the Stanton case said:

> ". . . it was considered equitable that lean years should be set off against lush ones to strike some sort of average, and hence we have the device of the 'unused excess profits credit carry-back and carry-over' from one tax year to another. Here we are interested only in the carry-over."

The loss carry-over in the present case and the excess profits carry-over in the Stanton Brewery case are for practical results the same.

Later in the Stanton opinion the Court observed that its ruling:

> [fol. 37] ". . . seems to us the one which will carry out the evident statutory purpose, since it accords the privileges of the carry-over provisions to what is essentially a continuing enterprise, entitled to all their benefits in ameliorating otherwise harsh tax consequences of fluctuating profits or expanding business."

Now we find the Stanton ruling shows signs of parting in similarity from this case. Is a merger of one holding company and one operating company, as was the Stanton record, comparable with a merger of seventeen corporations into one, as we have here? Can we, for Federal tax

purposes, call the latter "a continuing enterprise" of each of the 17 former corporations?

Minor changes by corporate reorganization are given weight in the Stanton case by this statement:

> "If there were real substance, for present purposes, to this conception of a corporate merger as a continuance of existence of the dominant corporation only, it would seem more in accord with business realities here to say that the larger and active operating business had taken over the inactive entity. It is true that upon his assumption the Commissioner may seem to avoid the dilemma of holding that a substantial tax credit is harshly destroyed by a comparatively minor change in corporate form."

Which brings us to the taxpayer's position here that the plaintiff, as the surviving corporation in a statutory merger, is essentially the same taxpayer as the merged corporation and is possessed of all their rights. This conclusion, the taxpayer says, is justified by the terms of the state statutes under which the merger was effected.

As we view the decisive question it is not whether the plaintiff, or merged corporation, is the same as the merged corporations, but is the survivor corporation the same as each of the corporations whose tax credit the merged corporation would appropriate? This question calls for examination of the corporate change effected.

Do we have a "comparatively minor change" in corporate form, as in the Stanton case? Take for example [fol. 38] Evanston Libson Shops, Inc., one of the merger corporations. It had $14,537.39 of the claimed tax reductions in suit. Can it be said that plaintiff, now taxpayer or merged corporation, is only a minor change from Evanston Libson Shops, Inc. To so hold, "minor change" would have to encompass a corporation passing from operating one store in East St. Louis, Illinois, to operating 16 other stores, the major portion of which are in another state.

The stock structure of Evanston Libson Shops, Inc., was $50,000.00 of shares having a par value of $100.00. Twenty shares were fully paid up, or $2,000.00. No further stock was ever issued. The merged corporation has 20,000 shares

of capital stock of $10.00 per share par value. Sixteen thousand shares are to be issued to the stockholders of all the 17 merged corporations. On confirmation of the merger by acceptance of the proposed charter all but plaintiff corporation ceased to exist.

There is a provision in the Articles (Third, III) for issuing the stock to the stockholders of the merged corporations without further payment:

> "III. The shares of Capital Stock of the Surviving Corporation issued pursuant to this Article Third shall upon such issuance be fully paid and non-assessable, inasmuch as the net worth of the Constituent Corporations is substantially in excess of the aggregate par value of such shares. To the extent that the par value of stock to be issued as aforesaid is in excess of the par value of the combined capital stock of the Constituent Corporations heretofore paid up and available therefor, such excess shall be paid up by transferring from Surplus Account of the Surviving Corporation to its Capital Account the amount necessary to pay up in full the capital stock of the Surviving Corporation so to be issued, the combined surplus of the Constituent Corporations being at this time in excess of the amount required for such purpose."

We conclude from this that treating the 17 corporations as one, rather than separate entities, when their financial structure was combined the fund referred to resulted. In [fol. 39] the scramble of corporations it is fair to conclude the stockholders of plaintiff received something of value, in stock holdings, and now hold it in their stock ownership of the merged corporation, which they did not hold prior to merger.

We are not informed as to the corporate powers of Evanston Libson Shops, Inc., except—"Each of these corporations, except Libson Shops Management Corporation, engaged in the business of retail selling of women's wearing apparel." Some of the powers of the plaintiff, as listed in the Articles, are:

> ". . . or otherwise dispose of letters patent of the United States or of any foreign country and all or

any rights, territorial or otherwise thereunder concerning hosiery, women's wear and wearing apparel, and the manufacture thereof; to apply for, acquire, hold, sell, assign, lease, mortgage or otherwise dispose of patent rights, licenses, privileges, inventions, trade-marks, trade names and pending applications therefor, relating to or useful in connection with hosiery, women's wear and wearing apparel, and the manufacture thereof; to use, manufacture, or grant licenses, under any letters patent owned or controlled by the corporation, and to expend money in experimenting upon and testing the validity or value of any patent rights the corporation may acquire or propose to acquire, apply for, purchase or otherwise acquire, hold, own, use, operate, sell, assign, grant or conduct licenses in respect to any and all inventions, improvements and processes used in connection with or secured under letters patent of the United States or elsewhere, in connection with hosiery, women's wear and other wearing apparel, or the manufacture or sale thereof; to acquire and undertake all or any part of the business, assets, good will, property, and liabilities of any person, firm, association or corporation in connection therewith; to take, acquire, purchase, hold, own, rent, lease, sell, exchange, mortgage, improve, cultivate, develop and otherwise deal in and dispose of any and all property, real and personal, of every description, incidental to or capable of being used in connection with the aforesaid businesses or any of [fol. 40] them; to borrow money necessary for the prosecution of the business of the corporation, and to give security for the payment thereof; to lease, mortgage, pledge, sell, convey or transfer such real or personal property as may be necessary for the transaction of the business of the corporation and to do all other things subsidiary, necessary or convenient for carrying out and into effect each and all of the aforesaid purposes and objects; and to do all things necessarily incident thereto.

"To purchase, hold, sell, assign, transfer, mortgage, pledge or otherwise ~~hold and~~ possess or otherwise dis-

pose of shares of capital stock or any bonds, securities or evidences of indebtedness created by any other corporation or corporations of this State or any other State, county, nation or government, and while the owner of said stock to exercise all the rights and powers and privileges of ownership, including the right to vote thereon.

* * * * * * *

"To supervise, manage, advise, purchase for, and otherwise handle retail stores, corporations, or other units that may deal or engage in the above said business purposes."

A further provision of the Articles of Incorporation is:

"Seventh: Upon this Merger becoming effective, the Surviving Corporation shall have all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under the General and Business Corporation Act of Missouri; and all property, real, personal and mixed, and all debts due on whatever account, including subscriptions to shares, and all other choses in action, and all and every other interest of or belonging to or due to each of the corporations so merged or consolidated shall be taken and deemed to be transferred to and vested in such Surviving Corporation without further act or deed; * * *"

This provision, and a necessary one to carry out the purpose of the merger, has its effect on plaintiff's claim. See New Colonial Co. v. Helvering, 292 U. S. 435, l. c. 441:

[fol. 41] "But, be this as it may, we are of opinion that in law and in fact the two corporations were not identical but distinct. This was plainly implied in the transfer of the assets and business from one to the other. That transaction was voluntary and contractual, not by operation of law. Thereafter neither corporation had any control over the other; the old corporation had no interest in the assets or business, and the chance of gain and the risk of loss were wholly with the new one."

Before leaving this subject we note a further provision of the "Agreement for Statutory Merger of Various Libson Corporations." Articles First and Second provide:

> "First: Libson Shops Management Corporation's corporate existence shall survive said merger and it shall continue as the surviving corporation under the name hereinafter specified. Said surviving corporation is hereinafter referred to as 'Surviving Corporation' or as the 'Corporation.'
>
> "Second: The Certificate of Incorporation of the Surviving Corporation shall be and is hereby amended so that the following statements and provisions shall be applicable to it: * * *"

This "surviving" corporation was one of the original seventeen corporations. What its structure was at time of merger the record does not show.

The stockholders of Evanston Libson Shops, Inc., and each of the remaining sixteen corporations were the same, and each shared in the treatment of the 17 corporations as a unit rather than as individual corporation stockholders. We have listed in part some of the results. We cannot on this record hold plaintiff and any one of the corporations, having either of tax credits in issue, is the same corporation.

We have not overlooked parts of the merger agreement favorable to plaintiff's plea. For illustration:

> ". . . [the other 16 corporations] be and are hereby merged into said Libson Shops Management [fol. 42] Corporation, and that the terms and conditions of the merger hereby agreed upon and the mode of carrying the same into effect are as follows: * * *"

There is language in the laws of the state concerned with the "merger" of the 17 corporations which taken literally lend further support to plaintiff's position of "same" corporation. But the laws of the state cannot for purpose of Federal taxation determine whether the corporations are the same.

To declare in the articles of merger, or point out a similar statement in the statute to the effect that a surviving

corporation is one and the same as one of the corporations whose stockholders' rights were merged into the survivor corporation, is under the facts of this record to deal in generalities and not to come to grips with the realities of the situation. There are far too many differences between the new or survival corporation and each of the old corporations that must fail to survive, to find the corporation surviving is for tax credit purposes the same as the corporations that have ceased to exist.

We have here three corporations that had tax credit and a corporation without tax credits that took over the assets of 16 corporations subject to their liabilities. It would take intricate mathematical calculation to ascertain what part of the value, if any, of stockholders' present holdings are represented by the old holding in the corporations that had losses resulting in the tax credits. These conclusions we think important and we shall presently comment on them.

Now coming to the statute. How shall it be construed?

> "* * * Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.
>
> "The statutes pertaining to the determination of taxable income have proceeded generally on the principle that there shall be a computation of gains and losses on the basis of a distinct accounting for each tax- [fol. 43] able year; and only in exceptional situations, clearly defined, has there been provision for an allowance for losses suffered in an earlier year. Not only so, but the statutes have disclosed a general purpose to confine allowable losses to the taxpayer sustaining them, i. e., to treat them as personal to him and not transferable to or usable by another.
>
> * * * * * * *
>
> "* * * Taken according to their natural import they mean that the taxpayer who sustained the loss is the one to whom the deduction shall be allowed. Had there been a purpose to depart from the general policy in that regard, and to make the right to the

deduction transferable or available to others than the taxpayer who sustained the loss, it is but reasonable to believe that purpose would have been clearly expressed. And as the section contains nothing which even approaches such an expression, it must be taken as not intended to make such a departure. (New Colonial Co. v. Helvering, supra, l. c. 440-441.)

The statute under which plaintiff must prevail, if at all, reads (26 U. S. C. § 122 (b) (2) (C)):

> "(C) [as added by Sec. 330, Revenue Act of 1951, c. 521, 65 Stat. 452] Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950. —If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years * * *."

Does plaintiff come within the terms of this statute? Plaintiff's counsel argues it does because the statute, after reciting if "the taxpayer has a net operating loss," in providing it shall be a carry-over," the statute does not [fol. 44] specifically say such carry-over shall be only to the taxpayer. Therefore counsel would bring the plaintiff within the statute by reason of such absence on the basis of relationship, whatever it may be, of the 16 corporations ceasing to the one corporation surviving.

We cannot read the statute as plaintiff does. If we were in doubt we would have that doubt removed by the New Colonial case, holding tax reductions are only allowed where there is a "clear" statute so providing. Doubt as to the meaning of the statute should be dispelled by that opinion saying that statutes have disclosed a general purpose to confine allowable losses to the "taxpayer" sustain-

ing them, and "to treat them as personal to him and not transferable to or usable by another."

This statute was before Congress since the ruling in the New Colonial case. We are bound to hold that if Congress wanted to repudiate that ruling as to its policy on tax credits it would have done so in plain language. It has not done so.

The Stanton Brewery case must be considered on its own facts. It is not a parallel to this case. We have set forth several striking illustrations of departure from the facts of this case. In so far as it might bear on this record in support of plaintiff's claim, we feel bound by the New Colonial case and refuse to follow the Stanton Brewery case.

The effect of a ruling such as plaintiff seeks would be establishing a precedent susceptible of wide-spread abuse. That is if Federal courts are to consider themselves bound by state laws and merger agreements under them in tax matters. Such a rule might result in a different Federal tax status for corporations in each state. In this case plaintiff boldly attempts to take a tax loss for a corporation that has ceased to exist, and transfer it for the benefit of another corporation or corporations with tax liabilities. If it is allowable in one case, it is allowable in all. The law must operate uniformly. It cannot make fish of one and fowl of another. And so bankrupt corporations with tax credits would find themselves the object of desirable [fol. 45] purchase or "merger" by or with corporations with tax liabilities, in order that after purchase the tax credits could be used to offset taxes due, just as plaintiff would do in this case. Regardless of what the motive or motives for including the corporations with tax credits in the merger, we have no doubt that use of their tax credits was one. The corporations holding the tax credits could not use them as apparently the stipulation indicates the stores operated by the corporations having tax credits continued to lose money.

II

The claim for a deduction of $1,500.00 arises from legal fees paid to a law firm to develop, formulate and carry

out the plan by which the corporate merger was effected. The original fee charged was for——

> ". . . to services, advice and consultation and attention to statutory merger of all companies; drafting of agreement, minutes and securing certificates."

The taxpayer took a deduction for the full amount of $2,500.00. It was disallowed in full as an expense in connection with reorganization, subject to a charge as a capital expense, needed to give the taxpayer an intangible asset in its altered corporate form.

By the present claim plaintiff acknowledges the Commissioner was right to the extent of $1,000.00 and now asks only for a deductible item of $1,500.00. This on the basis that the attorneys submitted several plans for a reorganization that were not accepted and that the legal expenses should be divided accordingly.

It is evident the client had one purpose in mind: A group of stockholders owned stock in several corporations. Some of the corporations were making money. Some were losing money. All were in the same business. How can the losses of some stores be credited on the gains of other stores? The assets of the 17 corporations presented a corporation with a better balance sheet for credit rating than did either corporation separately and certainly the corporations that had losses.

[fol. 46] One of the attorneys of the firm that carried out the enterprise testified:

> "Q. As a matter of fact, there were suggestions in the conferences leading up to the final and ultimate decision, and everything suggested in those conferences, sir, was designed to figure out the best way taxwise to get these sixteen units into one, is that a correct statement, sir?
>
> A. That is right.

Even on plaintiff's theory, to divide the services dollar for dollar for the abandoned plans and the acceptable plan impresses us as a difficult achievement. On this record one of the attorneys engaged made an arbitrary division for allocating the fee charged but we heard no substantial

evidence on which to base a finding of division in fact. Plaintiff has failed to carry the burden of proof that there was or is a division in fact in the services rendered.

Let judgment dismissing the claims be settled and presented.

Rubey M. Hulen, Judge.

UNITED STATES DISTRICT COURT, EASTERN DISTRICT OF MISSOURI, EASTERN DIVISION:

No. 9722 (2)

LIBSON SHOPS, INC., a corporation, Plaintiff

vs.

GUSTAVE F. KOEHLER, Defendant

JUDGMENT—April 15, 1955

This cause having come on for hearing on the 3rd day of January, 1955, and the plaintiff appearing by its counsel, and the defendant appearing by his counsel, and the [fol. 47] Court having before it a stipulation of facts, and having heard the oral testimony adduced at said hearing, and having considered briefs filed by and on behalf of both of said parties, and being duly advised in the premises, it is hereby

Ordered, Adjudged and Decreed that the complaint of the plaintiff be dismissed with prejudice and at the costs of plaintiff.

Rubey M. Hulen, United States District Judge.

IN UNITED STATES DISTRICT COURT

NOTICE OF APPEAL.—Filed June 13, 1955

[File endorsement omitted]

Notice is hereby given that Libson Shops, Inc., plaintiff above named, hereby appeals to the United States

Court of Appeals for the Eighth Circuit from the final judgment entered in this action on April 15, 1955.

Owen T. Armstrong, Attorney for Appellant, Libson Shops, Inc., 408 Olive Street, St. Louis 2, Mo.

Of Counsel: Lowenhaupt, Mattingly, Chasnoff & Stolar.

In United States District Court

Stipulation of Contents of Record on Appeal—Filed July 7, 1955

[File endorsement omitted]

Pursuant to the Notice of Appeal heretofore filed by the plaintiff in the above cause, the parties, by their respective counsel, hereby jointly designate the following parts of the record, proceedings and evidence to be included in the record on appeal:

[fol. 48] 1. Docket entries of proceedings in the District Court.

2. Pleadings as follows:

(a) Complaint, including Exhibit A thereto.
(b) Answer.

3. Stipulation of Facts, including Exhibits 1, 2 and 3 thereto.

4. Memorandum opinion embodying findings of fact and conclusions of law and directing the entry of judgment thereon.

5. Judgment entered April 15, 1955.

6. Notice of Appeal.

7. This Stipulation of Contents of Record on Appeal.

Owen T. Armstrong, Attorney for Plaintiff-Appellant, 408 Olive Street, St. Louis 2, Mo.

Of Counsel: Lowenhaupt, Mattingly, Chasnoff & Stolar, 408 Olive Street, St. Louis 2, Missouri.

H. Brian Holland, Assistant Attorney General, Tax Division.

IN UNITED STATES DISTRICT COURT

STATEMENT OF POINTS ON APPEAL.—Filed July 7, 1955

[File endorsement omitted.]

Comes now the appellant, Libson Shops, Inc., by its attorney, and respectfully states that the point on which it intends to rely on the appeal is as follows:

The District Court erred in concluding that the appellant, as the surviving corporation in a statutory merger, in computing its net income for a taxable period commenc-[fol. 49] ing on the date of the merger, is not entitled under Sections 23 (s) and 122 (b) (2) (C) of the Internal Revenue Code of 1939 (26 U. S. C., Secs. 23 (s), 122 (b) (2) (C) (1952)), to carry over and to deduct net operating losses sustained by several of the other merged corporations in taxable periods ended prior to the date of the merger.

Owen T. Armstrong, Attorney for Plaintiff-Appellant, 408 Olive Street, St. Louis 2, Mo.
Of Counsel: Lowenhaupt, Mattingly, Chasnoff & Stolar, 408 Olive Street, St. Louis 2, Missouri.

Service of above statement acknowledged:

Dated: June 27, 1955.

H. Brian Holland, Assistant Attorney General.

IN UNITED STATES DISTRICT COURT

CLERK'S DOCKET ENTRIES.

1954-

April 2—Complaint filed and summons issued thereon to deft.

April 15—Marshal's return filed. Summons executed April 4 and April 6, 1954.

June 2—Answer of deft. to complaint filed.

July 22—Set Monday, November 22, 1954.

November 17—By agreement, order heretofore entered

1954

setting cause for trial November 22, 1954 vacated and cause reset for trial on December 17, 1954.

December 15—By agreement and by leave, order heretofore entered setting cause for trial December 17, 1954 vacated and cause reset for trial January 3rd, 1955.

[fol. 50] 1955

January 3—Parties appear and announce ready for trial; whereupon final hearing of cause before the Court is commenced, concluded and issues submitted on briefs to be simultaneously presented within twenty days, and parties granted ten days thereafter to submit answering briefs if desired.

January 6—Transcript of testimony of Abraham Lowenhaupt given at trial of cause on January 3, 1955, filed by Official Court Reporter of Court #2.

February 15—On application of pltff., time within which pltff. and deft may submit answering briefs to briefs heretofore submitted by parties, extended to and including February 28, 1955.

March 23—Memo opinion of the Court embodying findings of fact and conclusions of law, filed determining issues on final hearing and directing judgment in accordance therewith dismissing pltff's claim be settled and presented.

April 15—Judgment filed and entered dismissing complaint with prejudice and at costs of plaintiff.

April 21—Deft's verified bill of costs filed.

June 13—Pltf's notice of appeal to U. S. Court of Appeals, 8th Circuit, from final judgment entered herein April 15, 1955, together with pltff's cost bond on said appeal in the sum of $250.00 filed. Copy of such notice of appeal forthwith transmitted by Clerk to U. S. Atty., as atty. for defendant. Pltff. deposited in the Registry $250.00 cash in lieu of other surety.

July 7—Stipulation of parties as to contents of record on appeal of pltff filed. Plaintiff's statement of points on such appeal filed.

A True Copy: Certified this 19th day of July, 1955.

James J. O'Connor, Clerk, By Annice W. Kinder, Deputy Clerk.

[fol. 51] UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

No. 15,397

LIBSON SHOPS, INC., Appellant

vs.

GUSTAVE F. KOEHLER, District Director of Internal Revenue, Appellee

Appeal from the United States District Court for the Eastern District of Missouri.

OPINION—January 19, 1956

Owen T. Armstrong (Lowenhaupt, Mattingly, Chasnoff and Stolar were with him on the brief), for Appellant.

Harry Marselli, Attorney, Department of Justice (H. Brian Holland, Assistant Attorney General, and Ellis N. Slack and Harry Baum, Attorneys, Department of Justice, and Harry Richards, United States Attorney, were on the brief), for Appellee.

Before GARDNER, Chief Judge, and WOODROUGH and VOGEL, Circuit Judges.

VOGEL, Circuit Judge.

The sole question involved in this case is whether the appellant, as the surviving corporation in a statutory merger [fol. 52] of seventeen separate corporations, in computing its net income for a taxble period commencing on the date of the merger, is entitled to carry-over and deduct net operating losses sustained by three of the merged corporations in taxable periods ended prior to the date of the merger under the provisions of §§23(s) and 122 (b)(2)(C) of the Internal Revenue Code of 1939 (26 U.S.C. §§23(s), 122 (b) (2)(C) (1952)).

The facts, as found by the district court and as stipulated by the parties, may be summarized as follows:

The appellant, Libson Shops, Inc., is a Missouri corporation with offices in St. Louis, Missouri. It was originally incorporated on January 2, 1946, as Libson Shops Management Corporation to supervise and manage certain other

corporations formed for the purpose of operating stores for the sale of women's wearing apparel. Its articles of incorporation also authorized it to engage in the business of selling apparel. Of the other corporations, ten were also incorporated in Missouri on January 2, 1946, one was incorporated in Missouri on January 8, 1946, and four were incorporated in Illinois on January 2, 1946. An additional corporation, Hampton Libson Shops, Inc., was incorporated in Missouri on May 28, 1948. All of the outstanding stock of each of the corporations was owned directly or indirectly by the same eight individuals and in the same proportions.

On August 1, 1949, pursuant to the laws of Missouri and Illinois, the seventeen separate operating corporations were merged into one, the taxpayer (appellant), and taxpayer's stock was issued in exchange for the stock of the merged corporations. Under the terms of the merger, the name of the taxpayer corporation was changed, the amount and par value of its stock was revised and its business purposes were extended. After the merger, the taxpayer, appellant, [fol. 53] operated the stores which had formerly been operated by the merged corporations.

Prior to the merger, two of the Illinois corporations and one Missouri corporation had sustained net operating losses from the respective businesses.

In the year following the merger, that is the taxable year involved herein, each of the businesses formerly operated by such three corporations continued to sustain a net operating loss.

In its income tax return for the first taxable year after the merger, the taxpayer claimed as a net operating loss carry-over and deduction the net operating losses sustained before the merger by the three corporations above referred to. Such deduction was disallowed by the commissioner and the appellant paid the resulting tax deficiency. It then claimed a refund which was disallowed; whereupon, it instituted the present action. The district court held that the claimed net operating loss deduction was not permissible under the law and sustained the commissioner's disallowance of the deduction. This is an appeal from the district court's action.

The statute involved, insofar as it may be applicable

herein, is as follows: Section 122 (b)(2)(C) Internal Revenue Code of 1939 as amended by Revenue Act of 1951, 65 Stat. 452, effective for taxable years beginning after December 31, 1948:

"(C) Loss for taxable year beginning after December 31, 1947, and before January 1, 1950. *If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years,* except that the carry-over in the case of each such succeeding taxable year (other [fol. 54] than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—". (Emphasis supplied.)

It is the appellant's position that the surviving corporation in a statutory merger, as distinguished from a new corporation in other kinds of reorganization, is entitled to carry over and deduct losses sustained in prior years by other parties to the reorganization.

Appellant concedes that in *New Colonial Ice Co., Inc.* v. *Helvering, Commissioner of Internal Revenue,* 1934, 292 U. S. 435, the Supreme Court ruled out the conclusion that the benefit of a carry-over extends to *any* successor. It argues that in the *New Colonial Ice* case, the statute involved was worded slightly different than that with which we are here concerned, in that it provided that where "* * * any taxpayer has sustained a net loss * * *" the same shall be deducted from the net income of "the taxpayer" for the succeeding taxable year, whereas the statute here does not repeat the term "taxpayer". That is, the statute does not say if the taxpayer has a loss, such loss shall be a carry-over for succeeding taxable years *of the taxpayer.* It takes the position that the failure to expressly repeat the term "the taxpayer" is significant as suggesting that the statute does not limit the right to the carry-over to the person who sustained the loss. Appellant points out that "the right to the carry-over is stated in the passive voice—the statute does not say that, if the taxpayer has a loss *he* shall be entitled to a loss carry-over; that it says only that such loss *shall be* a carry-over." From this ap-

pellant argues that Congress was not concerned with who sustained the loss but with the fact of the loss itself, and that it intended to confer the tax benefit thereof to anyone who could associate himself with the loss, such as a successor corporation in a corporate reorganization.

[fol. 55] Much is attempted to be made of little. We see no significance in the failure to repeat the term "taxpayer" in the present statute. In providing that if the taxpayer has a loss such loss shall be a carry-over, Congress could only have meant such carry-over was for the benefit of the taxpayer referred to. Had Congress intended that this right to a loss carry-over be transferable to someone other than the original taxpayer, it would have said so. In *New Colonial Ice Co., Inc.* v. *Helvering, Commissioner of Internal Revenue, supra,* the Supreme Court said, at page 440:

"* * * the statutes have disclosed a general purpose to confine allowable losses to the taxpayer sustaining them, *i.e.*, to treat them as personal to him and not transferable to or usable by another.

Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms."

The Supreme Court, in the case of *Interstate Transit Lines* v. *Commissioner of Internal Revenue,* 1943, 319 U.S. 590, 593, stated:

"* * * the now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer. *New Colonial Ice Co.* v. *Helvering,* 292 U.S. 435, 440; *Deputy* v. *du Pont,* 308 U.S. 488, 493."

In order to obtain credit for the loss carry-over appellant must establish that it is the same "taxpayer" having the net operating loss.

Arriving at the same conclusion, the trial court stated the question herein as follows:

"* * * is the survivor corporation the same as each of the corporations whose tax credit the merged corporation would appropriate?"

[fol. 56] It found that there had been much more than a

"comparatively minor change" (*Stanton Brewery, Inc.* v. *Commissioner of Internal Revenue*, (C.A. 2, 1949) 176 F.2d 573, 575) between the merged corporations and the appellant and concluded:

"We cannot on this record hold plaintiff and any one of the corporations having either of tax credits in issue, is the same corporation.

"There are far too many differences between the new or survival corporation and each of the old corporations that must fail to survive, to find the corporation surviving is for tax credit purposes the same as the corporations that have ceased to exist."

The trial court further stated:

"The effect of a ruling such as plaintiff seeks would be establishing a precedent susceptible of wide-spread abuse. That is if Federal courts are to consider themselves bound by state laws and merger agreements under them in tax matters. Such a rule might result in a different Federal tax status for corporations in each state. * * * The law must operate uniformly. It cannot make fish of one and fowl of another. And so bankrupt corporations with tax credits would find themselves the object of desirable purchase or 'merger' by or with corporations with tax liabilities, in order that after purchase the tax credits could be used to offset taxes due, just as plaintiff would do in this case. Regardless of what the motive or motives for including the corporations with tax credits in the merger, we have no doubt that use of their tax credits was one. The corporations holding the tax credits could not use them, as apparently the stipulation indicates the stores operated by the corporations having tax credits continued to lose money."

Appellant in this case relies principally upon *Stanton Brewery, Inc.* v. *Commissioner of Internal Revenue, supra.* The issue there, as stated by the majority opinion, was:

[fol. 57] "* * * whether or not, after a merger, the resulting corporation is entitled, in determining its adjusted excess profits net income, to carry over the unused excess profits credit of one of its components for the two years preceding the merger."

The John Stanton Brewing and Malting Company had merged with its wholly owned subsidiary, The Stanton Brewery, Inc. Both were New York corporations and the merger was effected under the New York stock corporation law. The John Stanton Brewing and Malting Company, with its name changed to The Stanton Brewery, Inc., was the surviving corporation. In determining its adjusted excess profits net income for 1942, the surviving corporation deducted the unused excess profits credits of its merged subsidiary for 1940 and 1941. The commissioner disallowed the deduction. The statute therein involved was § 710 (c) (3)(B) of the Internal Revenue Code of 1939, which in part provides:

"* * * If * * * the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-over for each of the two succeeding taxable years * * *." 26 U.S.C. § 710 (c)(3)(B).

In considering the purpose of the statute, the court said, at page 574:

"As is well known, Congress sought by the excess profits tax, I. R. C. §§ 710-736, 26 U.S.C.A. §§ 710-736—imposed in 1940 and repealed in 1945—to capture for the government the amount of corporate profits of any one year which were excessive in relation to the like receipts during an earlier or base period (normally 1936-1939). But it was considered equitable that lean years should be set off against lush ones to strike some sort of average, and hence we have the device of the 'unused excess profits credit carry-back and carry-over' from one tax year to another."

The court held therein that since the successor corporation became directly liable under the laws of the State of New [fol. 58] York for outstanding debts of the merged corporation, it should be deemed to be the same "taxpayer" as the merged corporation for purposes of applying the carry-over provision. It said that the successor corporation was a "* * * union of component corporations into an all-embracing whole which absorbs the rights and privileges, as well as the obligations, of its constituents," by operation of state law and accordingly was the "taxpayer" presently

obligated to pay their taxes and entitled to their credits under the federal tax law.

The court stated, at page 577:

"Our conclusion that petitioner is entitled to the unused excess profits credit carry-overs of its component corporations seems to us, therefore, the reasonable interpretation of the statutory language. Moreover it seems to us *the one which will carry out the evident statutory purpose, since it accords the privileges of the carry-over provisions to what is essentially a continuing enterprise,* entitled to all their benefits in ameliorating otherwise harsh tax consequences of fluctuating profits or expanding business." (Emphasis supplied.)

In a strongly dissenting opinion in the *Stanton* case, Judge Learned Hand stated, at page 578:

"A statute so intricate and detailed as this leaves little latitude for interpretation. Moreover, I do not think that it is more consistent with any declared purpose that I can find, to extend the privilege of a 'carry-over' to the taxpayer at bar. Indeed, as the decisions cited in my brothers' opinion show, privileges, closely akin in purpose to this, are ordinarily lost by transfers by one corporation to another; and the form of the transfer cannot be important. We have no warrant for supposing that Congress in general regards such credits as parts of a 'universitas juris,' passing, with the chattels, choses in action and the rest, like good-will or trade-marks."

[fol. 59] Without taking issue with the majority's opinion in the *Stanton* case, we point out that it is distinguishable on its facts. The *Stanton* case involved the merger of one operating corporation and a parent holding company. The business carried on after the merger was substantially the same as that which had theretofore been carried on by the merged operating corporation, and without the merger the latter would have been entitled to the claimed carry-over. The majority opinion refers to the fact that the privilege of the carry-over is accorded to what they refer to as "essentially a continuing enterprise".

In the case before us, we do not have "essentially a continuing enterprise". We are concerned with the merger of seventeen corporations, each of them operating an individual enterprise. Sixteen of the corporations operated sixteen individual stores in sixteen different places, four of them in Illinois and the remainder in Missouri. The seventeenth corporation provided supervisory and managerial services for the other sixteen. The appellant here is attempting to pool seventeen separate enterprises and level the ups and downs of their economic fortunes. We can see no distinction (except corporation as opposed to individual) between the situation confronting us in this case and that in which seventeen individuals, each owning and operating a separate and distinct business, trying to pool their resources and liabilities into one ownership and thereby attempting to take credit for the loss carry-overs of three of the individuals whose enterprises had not returned a profit in the years prior to the combined ownership. The rule contended for by appellant would obviously give unfair advantage to corporations over individuals.

Uniformity of administration of tax laws should be assured all taxpayers.

[fol. 60] It is argued that all of the outstanding stock of each of the corporations was owned directly or indirectly by the same individuals and in the same proportions, and that those stockholders have a like interest in the merged corporation, the appellant herein. In other words, we are asked to look behind the corporate fiction to the true owners, the stockholders.

In dealing with a somewhat similar contention, the Supreme Court in *New Colonial Ice Co., Inc.* v. *Helvering*, supra, stated, at page 441:

"Thus the contention that the two corporations were practically the same entity and therefore the same taxpayer has no basis, unless as the petitioner insists, the fact that the stockholders of the two corporations were substantially the same constitutes such a basis.

"As a geneal rule a corporation and its stockholders are deemed separate entities (*Pullman Car Co.* v. *Missouri Pacific Ry. Co.*, 115 U.S. 587, 596-597; *Donnell* v. *Herring-Hall-Marvin Safe Co.*, 208 U.S. 267, 273; *United States* v. *Dela-*

ware, L. & W. R. Co., 238 U.S. 516, 527-529; *Cannon Mfg. Co.* v. *Cudahy Co.*, 267 U.S. 333; *Klein* v. *Board of Supervisors*, 282 U.S. 19, 24.) and this is true in respect of tax problems. (*Klein* v. *Board of Supervisors*, 282 U.S. 19, 24; *Dalton* v. *Bowers*, 287 U.S. 404, 410; *Burnet* v. *Clark*, 287 U.S. 410, 415; *Burnet* v. *Commonwealth Improvement Co.*, 287 U.S. 415, 418-420.)"

Page 437:

"The question presented is—where all the assets and business of an older corporation are taken over by a new corporation, specially organized for the purpose and having substantially the same capital structure, in exchange for a portion of its stock, which is distributed by the older corporation among the latter's stockholders share for share, thereby retiring the old shares, is the new corporation entitled, notwithstanding the change in corporate identity and ownership, to have its taxable income for the succeeding [fol. 61] period computed and determined by deducting from its net income for that period the net losses sustained by the older corporation in the preceding period?"

Page 439:

"The petitioner insists that *the continuity of the business was not broken* by the transfer from the old company to the new; and this may be conceded. But it should be observed that this continuity was accomplished by deliberate elimination of the old company and substitution of the new one. Besides, *the matter of importance here, as will be shown presently, is not continuity of business alone but of ownership and tax liability as well.* Had the transfer from one company to the other been effected by an unconditional sale for cash there would have been continuity of business, but not of ownership or tax liability." (Emphasis supplied.)

"Petitioner also insists that the ultimate parties in interest—stockholders and creditors—were substantially the same after the transfer as before; and this may be conceded. But there is here no effort to tax either creditors or stockholders."

Page 440:

"* * * but the statutes have disclosed a general purpose to confine allowable losses to the taxpayer sustaining them, *i.e.*, to treat them as personal to him and not transferable to or usable by another."

"When §204 (b) is read with the general policy of the statutes in mind, as it should be, we think it cannot be regarded as giving any support to the deduction here claimed. It brings into the statutes an exceptional provision declaring that where for one year 'any taxpayer has sustained a net loss' the same shall be deducted from the net income of 'the taxpayer' for the succeeding taxable year; and, if such loss be in excess of the income for that year, the excess shall be deducted from the net income for the next succeeding taxable year. Its words are plain and free from ambiguity. Taken according to their natural import they mean that the taxpayer who sustained the loss is the one to whom the de- [fol. 62] duction shall be allowed. Had there been a purpose to depart from the general policy in that regard, and to make the right to the deduction transferable or available to others than the taxpayer who sustained the loss, it is but reasonable to believe that purpose would have been clearly expressed."

Appellant herein would avoid the import of the *New Colonial Ice* case by directing attention to the fact that that case did not involve a statutory merger of corporations and the instant case does. Appellant accordingly believes that the *Stanton* case is authority for its contention and that the *New Colonial Ice* case is not in point. As we have previously indicated, however, there is factual difference between the instant case and *Stanton*. That is true as to *New Colonial Ice* as well. It does not, however, detract from the force of the Supreme Court's statements in *New Colonial Ice*, supra, and that "* * * the matter of importance here * * * is not continuity of business alone but ownership and tax liability as well".

In tracing the identity of the "taxpayer", it would appear that the Supreme Court was concerned with both continuity of ownership and continuity of business. In the instant case we have seventeen separate businesses now

merged into one. We are of the opinion that this case lacks both of the essential elements necessary to establishing the appellant as the "taxpayer" entitled to the deduction. There is here neither continuity of ownership nor continuity of business.

While we do not consider it as a logical argument against the appellant's position and is, after a fashion, arguing backwards, it is nevertheless pointed out that to allow the credit here would produce a most unusual result. It would mean that *the merger* of these corporations *and the merger alone* would be responsible for the appellant obtaining the credit sought, for if the three corporations sustaining the [fol. 63] loss had not merged they would not have been able to take credit for the loss carry-over as they continued to sustain losses. Thus the appellant here is seeking solely by virtue of the merger of the corporations to obtain a benefit which would not have been available to the individual corporations themselves. The income against which appellant seeks to offset the loss did not come from the same business enterprises which gave rise to the loss. Congress intended by the statute involved to level out the ups and downs of *individual business enterprises, not combinations thereof* owned by different taxpayers.

Since this case was argued, there has been called to our attention a case of the United States Court of Appeals for the Ninth Circuit, *E. & J. Gallo Winery, a corp., Petitioner,* v. *Commissioner of Internal Revenue,* No. 14,180, decided November 9, 1955. That case involved a statutory merger of two corporations under the laws of California. The facts disclosed in the opinion do not indicate whether or not there was involved a continuing enterprise, that is, "continuity of business". The court therein distinguished the case before it from the *New Colonial Ice* case on the ground that in the *Gallo* case there was a true statutory merger and in the *New Colonial Ice* case "there was nothing resembling a merger". Relying strongly on the *Stanton* case, the court said, page 8:

"We hold and *Stanton* held, that the surviving corporation is the 'taxpayer', who may use the unused excess profits tax credit of the former corporation."

Apparently the *Gallo* and *Stanton* cases stand on the same footing. Nevertheless, insofar as it can be said that they are parallel with the instant case, we must conclude that they are not persuasive.

[fol. 64] Appellant also cites in support of its contention *Helvering, Commissioner of Internal Revenue* v. *Metropolitan Edison Co.*, 1939, 306 U.S. 522. In that case, the court stated, at page 523:

"These cases present the question whether, under the Revenue Acts of 1926 and 1928, a Pennsylvania corporation may deduct unamortized bond discount and expense in connection with redemption of the bonds of a subsidiary, all of whose assets it had previously acquired pursuant to local law."

That case holds that where a transferee corporation becomes liable for the debts of the transferor because of a merger, it may deduct losses or expenses arising out of the assumed debts, such as unamortized discount on bonds issued by the transferor. That is not the situation confronting the court in this case. The appellant here is not attempting to deduct a post-merger expense or loss of its own arising out of the assumption of the debts of the merged corporations, but to carry over and deduct pre-merger operating losses of three of the merged corporations. Furthermore, in the *Metropolitan Edison* case, the Supreme Court stated, at page 529:

"It is important to note, however, that amongst the liabilities assumed were bonds on which the parent company was already liable as guarantor."

We do not consider *Metropolitan Edison* as authority for appellant's contention.

It is significant, in drawing fact distinctions between the case at bar and those relied on by the appellant, that the merged corporations in the present instance were not all of the same state. Of the three corporations which sustained losses which the appellant is attempting to take as net operating loss carry-overs, two of such corporations were from the State of Illinois and one from the State of Missouri. We find it particularly difficult to say that two legal entities

[fol. 65] brought into existence by the laws of the State of Illinois are now identical with and have become a creature brought into existence by the laws of Missouri.

In *Newmarket Mfg. Co.* v. *United States,* (D. C. Mass. 1955) 130 F. Supp. 706, the court had before it a situation almost on all fours with that confronting this court. There a Massachusetts corporation had caused the organization of a Delaware corporation. Subsequently the Massachusetts corporation was merged into and consoliated with the Delaware corporation. The consolidated corporation became liable for all the obligations of the Massachusetts corporation. It had the same business as the Massachusetts corporation, the same officers, the same stockholders and the same outstanding stock certificates. After the merger, the Massachusetts corporation ceased to exist as a separate corporation. The question there was whether, under § 122 of the Revenue Code of 1939, as amended, 26 U.S.C.A. § 122, " * * * a net operating loss incurred by the consolidated corporation in its fiscal year December 1, 1951, to November 30, 1952 (that is, after the merger) may be carried back to be deducted, from the income tax liability attributable to the separate operations of the Massachusetts corporation for the period * * *" before the merger.

In a well-reasoned opinion, the court therein stated, at page 707:

"Where identity between the merging corporations and the consolidated corporation is recognized by local law, then, so the argument runs, the federal tax law accepts the identity. Indeed, it is said, such identity has been recognized in connection with carry-back provisions, *Moldit, Inc.* v. *Jarecki*, D.C. N.D. Ill., Aug. 13, 1953, (P. H. par. 72, 681), as well as in connection with unused excess profits credits. *Stanton Brewery, Inc.,* v. *Commissioner,* 2 Cir., 176 F. 2d 573.

There are two fundamental vices in this argument. First is the erroneous assumption that the federal tax law deter-[fol. 66] mines the identity of the taxpayer under federal law by reference to state rules of law or private agreements governing mergers. However, the question whether the same taxpayer is involved in two different accounting periods under federal law is to be decided exclusively by federal

tax law. Second is the fallacious proposition that the Delaware corporation is the same person as the Massachusetts corporation merely having, as plaintiff's brief contends, another domicile and another name. However, even if the situation at bar involved two corporations chartered by the same state it would not be true that the identity of one corporation survives when merged with another."

The court held:

"* * * that under § 122 of the Internal Revenue Code of 1939 a consolidated corporation cannot carry back its losses in one year to reduce the tax liability incurred in an earlier year due to operations of one of its constituent corporations."

When Congress passed the statute here involved it was concerned with eliminating inequality, taxwise, between a business with alternating profit and loss as compared with a business with stable profits. It allowed the lean years of a business with alternating profit and loss to be set-off against the good years so as to strike an equitable tax liability as compared to a business having steady profits. We find nothing to suggest that Congress intended that a number of individual enterprises could pool their economic ups and downs and thus level off their tax burden between them. Congress was concerned with the economic fortunes of individual taxpayers, not combinations thereof.

Affirmed.

[fol. 67] UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT—September Term, 1955

No. 15397

LIBSON SHOPS, INC., Appellant,

vs.

GUSTAVE F. KOEHLER, District Director of Internal Revenue

Appeal from the United States District Court for the Eastern District of Missouri.

JUDGMENT—January 19, 1956

This cause came on to be heard on the record from the United States District Court for the Eastern District of Missouri, and was argued by counsel.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the judgment of the said District Court, in this cause, be, and the same is hereby, affirmed.

January 19, 1956.

[fol. 68] Petition for rehearing covering 7 pages filed, omitted from this print. It was denied, and nothing more by order.

[fol. 69] UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

[Title Omitted]

ORDER DENYING PETITION OF APPELLANT FOR REHEARING—February 16, 1956

Appeal from the United States District Court for the Eastern District of Missouri.

Petition of appellant for a rehearing filed in this cause has been considered, and It is now here Ordered by this Court that the said petition, be and it is hereby, denied.

February 16, 1956.

[fol. 70] ORDER STAYING ISSUANCE OF MANDATE (Omitted in Printing)

[fol. 71] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 72] SUPREME COURT OF THE UNITED STATES.

[Title Omitted]

ORDER ALLOWING CERTIORARI—Filed June 4, 1956

The petition herein for a writ of certiorari to the United States Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(774-0)

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SUPREME COURT OF THE UNITED STATES.

LIBSON SHOPS, INC.,
Petitioner,

vs.

GUSTAVE F. KOEHLER, DISTRICT DIRECTOR OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

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INDEX.

	Page
Jurisdiction	2
Question Presented	2
Statutes Involved	2
Statement of the Case	3
Reasons for Allowance of the Writ	5
Argument	6
Prayer	10
Appendix	13

Table of Cases.

E. & J. Gallo Winery v. Commissioner of Internal Revenue, 227 F. (2d) 699 (9th Cir., 1955) 5, 8, 9, 10

Stanton Brewery, Inc., v. Commissioner of Internal Revenue, 176 F. (2d) 573 (2d Cir., 1949) .. 5, 6, 7, 8, 9, 10

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1955.

LIBSON SHOPS, INC.,
Petitioner,

vs.

GUSTAVE F. KOEHLER, DISTRICT DIRECTOR OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Eighth Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Libson Shops, Inc., a Missouri corporation, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit in the cause styled "Libson Shops, Inc., Appellant, v. Gustave F. Koehler, Appellee," affirming the judgment of the United States District Court for the Eastern Judicial District of Missouri, Eastern Division.

The opinion of the Court of Appeals is reported at 229 F. (2d) 220, and a copy thereof is appended. A memorandum of the District Court containing findings of fact and conclusions of law is reported by Prentice-Hall at par. 72,721, 1955 Federal Tax cases and by Commerce Clearing House at 55-1 U. S. T. C., par. 9458, and a copy thereof is included in the record printed for the use of the Court of Appeals, nine copies of which are furnished pursuant to Rule 21.

JURISDICTION.

The judgment of the Court of Appeals was entered January 19, 1956. An order denying petition of appellant for rehearing was entered February 16, 1956. Jurisdiction of this Court to review the judgment of the Court of Appeals is conferred by the Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U. S. C., § 1254.

QUESTION PRESENTED.

The question presented for review is whether the petitioner, as the surviving corporation in a statutory merger of the petitioner and 16 other corporations, in computing its federal income tax for petitioner's taxable period commencing on the date of the merger, is entitled to carry over and deduct from its gross income certain net operating losses sustained by three of the other merged corporations in taxable periods ended prior to the merger.

STATUTES INVOLVED.

The statutes involved are the Internal Revenue Code of 1939, Sections 23 (s) and 122, Section 211, Revenue Act of 1939, c. 247, 53 Stat. 862, as amended, particularly 122 (b) (2) (C), Section 330, Revenue Act of 1951, c. 521, 65 Stat. 452 [26 U. S. C., 1952 ed., Sections 23 (s), 122].

The pertinent text of the above statutes is appended.

STATEMENT OF THE CASE.

Petitioner is a Missouri corporation with offices in St. Louis, Missouri. The respondent is a former District Director of Internal Revenue for the District of St. Louis, Missouri. The case was commenced in the District Court as an action to recover the sum of approximately $13,000 in federal income tax and interest thereon alleged by petitioner to have been overpaid for its fiscal year ended July 31, 1950. The District Court's jurisdiction was based upon the Act of June 25, 1948, c. 646, 62 Stat. 932, 28 U. S. C., § 1340.

Petitioner was incorporated in Missouri on January 2, 1946, as Libson Shops Management Corporation, to supervise and manage the operations of certain other corporations incorporated at the same time or shortly thereafter, some in Missouri, and others in Illinois, for the sale at retail of ladies' apparel in shops located in those states. All of the outstanding stock of the petitioner and of each of the sixteen sales corporations was owned directly or indirectly by the same eight individuals and in the same proportions.

On August 1, 1949, petitioner and the other sixteen corporations merged under and in accordance with the laws of Missouri and the laws of Illinois. Pursuant to the terms of the merger, petitioner, with its corporate name changed to Libson Shops, Inc., was the surviving corporation; the petitioner revised its capital structure, and its stock was issued in exchange for the stock of the merged corporations, in the same proportions in which the stockholders had owned stock in the merged corporations.

Prior to the merger, two of the Illinois sales corporations and one of the Missouri sales corporations had sustained net operating losses from their respective businesses,

and each had an unused net operating loss carry-over at the time of the merger. After the merger, petitioner operated all of the stores which formerly had been operated by the respective merged corporations. Petitioner maintained separate accounting records for each of the stores. The stores formerly operated by the three corporations which had net operating loss carry-overs at the time of the merger sustained operating losses in the year following the merger.

In its income tax return for its first taxable year after the merger, petitioner claimed the aggregate amount of the net operating loss carry-overs from the said three corporations as a deduction. This deduction was disallowed by the Commissioner of Internal Revenue. Petitioner paid an asserted deficiency resulting in part from said deduction and filed a claim for refund, which was disallowed. Petitioner then instituted the present action in the District Court, which held petitioner was not entitled to the net operating loss deduction.

Petitioner appealed the decision of the District Court to the Court of Appeals. The sole question on the appeal was whether the petitioner, the surviving corporation in the statutory merger, is entitled after the merger to take a net operating loss deduction attributable to losses sustained by several of the merged corporations prior to the merger.

The material part of Section 122 (b) (2) (C) of the Internal Revenue Code of 1939, as amended, provides as follows:

> "(C) **Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950.**—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net

operating loss carry-over for each of the three succeeding taxable years, * * *"

The Court of Appeals affirmed the judgment of the District Court, holding petitioner was not entitled under the statute to the net operating loss deduction it claimed.

REASONS FOR ALLOWANCE OF THE WRIT.

The decision of the Court of Appeals in this case is in conflict with the decisions of two other Courts of Appeals on substantially the same question.

The conflicting decisions are as follows:

1. The decision of the Court of Appeals for the Second Circuit in **Stanton Brewery, Inc., v. Commissioner of Internal Revenue**, 176 F. (2d) 573 (1949), holding that the surviving corporation in a statutory merger under New York law was entitled under Section 710 (c) (3) (B) of the Internal Revenue Code of 1939 to carry over unused excess profits tax credits of the other merged corporation.

2. The decision of the Court of Appeals for the Ninth Circuit in **E. & J. Gallo Winery v. Commissioner of Internal Revenue**, 227 F. (2d) 699 (November 9, 1955), holding that the surviving corporation in a statutory merger under California law was entitled under Section 710 (c) (3) (B) of the Internal Revenue Code of 1939 to carry over an unused excess profits tax credit of the other merged corporation.

ARGUMENT.

1. The decision in the instant case is in direct conflict with the decision in the **Stanton Brewery** case.

In **Stanton Brewery**, it appeared that on December 31, 1941, the John Stanton Brewing and Malting Company had merged with its wholly-owned subsidiary, The Stanton Brewery, Inc. Both were New York corporations and the merger was effected under the New York Stock Corporation Law. The John Stanton Brewing and Malting Company, with its name changed to The Stanton Brewery, Inc., was the surviving corporation. In determining its adjusted excess profits net income for 1942, the surviving corporation deducted the unused excess profits credits of its merged subsidiary for 1940 and 1941. The Commissioner disallowed the deduction.

The tax statute involved was Section 710 (c) (3) (B) of the Internal Revenue Code of 1939, which in part provides:

> ". . . If . . . the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-over for each of the two succeeding taxable years . . ." 56 Stat. 901; 26 U. S. C., Sec. 710 (c) (3) (B).

The Second Circuit held that the surviving corporation in the merger was entitled to the carry-over.

The rationale of the decision in **Stanton Brewery** is as follows:

> (i) "Petitioner's claim is that, as 'the taxpayer' in the quotation [from Section 710 (c) (3) (B), supra] it is entitled to the carry-over from its component operating company's unused excess profits credit." l. c. 574.
>
> (ii) "'Taxpayer' is defined as 'any person subject to a tax imposed by this title' by I. R. C., Sec. 3797,

26 U. S. C. A., Sec. 3797, which also defines 'person' to include 'corporation.'" l. c. 576.

(iii) Petitioner, as the resulting corporation in a merger, "is liable for the taxes imposed upon its components." l. c. 576.

(iv) "Hence we conclude that . . . petitioner, who has absorbed the two former corporations, is 'the taxpayer' now obligated to pay their taxes and entitled to their credits." l. c. 576.

Comparing the **Stanton Brewery** case with the instant case, it is clear that the decisions are in conflict.

Section 122 (b) (2) (C), here involved, dealing with net operating loss carry-over, is otherwise identical in terms with Section 710 (c) (3) (B), dealing with unused excess profits credit carry-over, involved in **Stanton Brewery.**

The **Stanton Brewery** rationale, applied to the facts of the instant case, leads to the conclusion that petitioner is entitled to the carry-over:

(i) Petitioner is so entitled if it is "the taxpayer" within the meaning of Section 122 (b) (2) (C).

(ii) The statutory definition of "taxpayer" cited by the Court in **Stanton Brewery** applies here as well as there.

(iii) Petitioner here is subject to liability for taxes imposed upon the other merged Libson corporations, under the reasoning of the cases cited by the Second Circuit [176 F. (2d) 575] as applied to a surviving corporation in a merger pursuant to the Missouri and Illinois statutes.

(iv) Hence petitioner here is "the taxpayer" in Section 122 (b) (2) (C), entitled to the loss carry-over credits of the three merged corporations.

The Eighth Circuit Court of Appeals attempts to distinguish **Stanton Brewery** as involving the merger of one

operating corporation and a parent holding company, whereas the instant case involves the merger of 16 sales corporations and a management corporation. 229 F. (2d) 224.

The Court of Appeals regards this difference as material, because of the reference in **Stanton Brewery** to "a continuing enterprise." 176 F. (2d) 577.

The point is made that where there is only a single operating corporation both before and after the merger, there is a "continuing enterprise," but not so where there are several operating corporations before the merger. It is not necessary to consider whether this is a proper interpretation of the phrase used by the Second Circuit, because the reference to "continuing enterprise" does not enter into the essential rationale of the decision. The Court had already reached its conclusion, on the basis of the **language** of the statute before it, before making the reference to "continuing enterprise" in the course of discussing the **purpose** of the statute. 176 F. (2d) 577.

2. The decision of the Court of Appeals is also in direct conflict with the decision of the Ninth Circuit Court of Appeals in **E. & J. Gallo Winery v. Commissioner of Internal Revenue**, 227 F. (2d) 699 (November 9, 1955).

In that case it appeared that on December 19, 1945, Gallo Winery and Valley Agricultural Company, both California corporations, merged in accordance with Section 361 of the California Civil Code. Gallo Winery was the surviving corporation. At the time of the merger Valley Agricultural Company had an unused excess profits credit. The sole question on the appeal was whether Gallo Winery was entitled to use this credit as a carry-over in computing its excess profits tax net income for its taxable year ended April 30, 1946.

The tax statute involved was Section 710 (c) (3) (B) of the Internal Revenue Code of 1939, the same statute that was involved in the **Stanton Brewery** case, supra.

The Ninth Circuit held that Gallo Winery was entitled to the carry-over.

The rationale of the decision is as follows:

(i) In order to be entitled to the carry-over under Section 710, Gallo Winery must be "the taxpayer" within the meaning of the statute. l. c. 704.

(ii) Under applicable decisions of the United States Supreme Court, in all cases of corporate merger the identity of each merged corporation is deemed to persist in the surviving corporation for purposes of enabling the survivor to utilize tax credits of the other. This is true whether or not state law is held to control in determining the character and content of the continuing corporation in a merger, and whether or not there is a true statutory merger. l. c. 702-704.

(iii) The merger of Gallo Winery and Valley Agricultural Company was a statutory merger under California law, with the result that Valley in legal effect became an integral part of Gallo, citing Civil Code of California, Section 361 (5) and (7). l. c. 702. In any event there was a merger with the result, according to the Supreme Court decisions, that the corporate personality of Valley was "drowned" in that of Gallo. l. c. 705.

(iv) Thus Gallo was "the taxpayer" within Section 710 (c) (3) (B) of the Internal Revenue Code, and was entitled to the carry-over. l. c. 704-705.

Again, comparison of the **Gallo Winery** case with the instant case clearly points up the conflict in the decisions.

The language of the tax statutes is the same, as noted above.

The decisions of the Supreme Court referred to in **Gallo** are as applicable here as there. There was a merger here as in that case. Where the California merger statute (Sec. 361 [5]) says that the merging corporations "shall be one corporation," 227 F. (2d) 702, the corresponding Missouri and Illinois statutes say that they "shall be a single corporation." Mo. R. S., 1949, Section 351.450, and Smith-Hurd, Illinois Annotated Statutes, Section 157.69. Likewise the Missouri and Illinois statutes above cited provide that upon merger "the **separate** existence . . . shall cease" (emphasis supplied), which is the identical language used in the California statute. 227 F. (2d) 702.

The Court of Appeals in the present case made only a feeble effort to distinguish **Gallo Winery**. The Court first suggested that the case might be distinguishable as involving a "continuing enterprise" within the supposed meaning of that phrase as used in **Stanton Brewery**, but conceded that the facts disclosed in the opinion of the Ninth Circuit do not show this to be true (l. c. 226). In any event, this factor did not enter into the decision in **Gallo Winery**.

The Court then concluded:

> "Apparently the Gallo and Stanton cases stand on the same footing. Nevertheless, insofar as it can be said that they are parallel with the instant case, we must conclude that they are not persuasive." 229 F. (2d) 227.

Wherefore, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Eighth Circuit, commanding that Court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceed-

ings in the case numbered and entitled on its docket, No. 15,397, Libson Shops, Inc., Appellant, v. Gustave F. Koehler, District Director of Internal Revenue, Appellee; and that the said judgment of the United States Court of Appeals may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

Respectfully submitted,

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Counsel for Petitioner.

Of Counsel:

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FREEMAN & HOLLAND.

APPENDIX.

1. Opinion of the Court of Appeals:

UNITED STATES COURT OF APPEALS
for the Eighth Circuit.

No. 15,397.

Libson Shops, Inc., Appellant,

vs.

Gustave F. Koehler, District Director of Internal Revenue, Appellee.

Appeal from the United States District Court for the Eastern District of Missouri.

[January 19, 1956.]

Owen T. Armstrong (Lowenhaupt, Mattingly, Chasnoff and Stolar were with him on the brief), for Appellant.

Harry Marselli, Attorney, Department of Justice (H. Brian Holland, Assistant Attorney General, and Ellis N. Slack and Harry Baum, Attorneys, Department of Justice, and Harry Richards, United States Attorney, were on the brief), for Appellee.

Before Gardner, Chief Judge, and Woodrough and Vogel, Circuit Judges.

Vogel, Circuit Judge.

The sole question involved in this case is whether the appellant, as the surviving corporation in a statutory merger of seventeen separate corporations, in computing

its net income for a taxable period commencing on the date of the merger, is entitled to carry over and deduct net operating losses sustained by three of the merged corporations in taxable periods ended prior to the date of the merger under the provisions of §§ 23(s) and 122 (b) (2) (C) of the Internal Revenue Code of 1939 (26 U. S. C. §§ 23(s), 122 (b) (2) (C) (1952)).

The facts, as found by the district court and as stipulated by the parties, may be summarized as follows:

The appellant, Libson Shops, Inc., is a Missouri corporation with offices in St. Louis, Missouri. It was originally incorporated on January 2, 1946, as Libson Shops Management Corporation to supervise and manage certain other corporations formed for the purpose of operating stores for the sale of women's wearing apparel. Its articles of incorporation also authorized it to engage in the business of selling apparel. Of the other corporations, ten were also incorporated in Missouri on January 2, 1946, one was incorporated in Missouri on January 8, 1946, and four were incorporated in Illinois on January 2, 1946. An additional corporation, Hampton Libson Shops, Inc., was incorporated in Missouri on May 28, 1948. All of the outstanding stock of each of the corporations was owned directly or indirectly by the same eight individuals and in the same proportions.

On August 1, 1949, pursuant to the laws of Missouri and Illinois, the seventeen separate operating corporations were merged into one, the taxpayer (appellant), and taxpayer's stock was issued in exchange for the stock of the merged corporations. Under the terms of the merger, the name of the taxpayer corporation was changed, the amount and par value of its stock was revised and its business purposes were extended. After the merger, the taxpayer, appellant, operated the stores which had formerly been operated by the merged corporations.

Prior to the merger, two of the Illinois corporations and one Missouri corporation had sustained net operating losses from their respective businesses.

In the year following the merger, that is the taxable year involved herein, each of the businesses formerly operated by such three corporations continued to sustain a net operating loss.

In its income tax return for the first taxable year after the merger, the taxpayer claimed as a net operating loss carry-over and deduction the net operating losses sustained before the merger by the three corporations above referred to. Such deduction was disallowed by the commissioner and the appellant paid the resulting tax deficiency. It then claimed a refund which was disallowed; whereupon, it instituted the present action. The district court held that the claimed net operating loss deduction was not permissible under the law and sustained the commissioner's disallowance of the deduction. This is an appeal from the district court's action.

The statute involved, insofar as it may be applicable herein, is as follows: Section 122 (b) (2) (C) Internal Revenue Code of 1939 as amended by Revenue Act of 1951, 65 Stat. 452, effective for taxable years beginning after December 31, 1948:

> "(C) Loss for taxable year beginning after December 31, 1947, and before January 1, 1950. **If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years,** except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed." (Emphasis supplied.)

It is the appellant's position that the surviving corporation in a statutory merger, as distinguished from a new corporation in other kinds of reorganization, is entitled to carry over and deduct losses sustained in prior years by other parties to the reorganization.

Appellant concedes that in **New Colonial Ice Co., Inc. v. Helvering, Commissioner of Internal Revenue,** 1934, 292 U. S. 435, the Supreme Court ruled out the conclusion that the benefit of a carry-over extends to **any** successor. It argues that in the **New Colonial Ice** case, the statute involved was worded slightly differently than that with which we are here concerned, in that it provided that where "* * * any taxpayer has sustained a net loss * * *" the same shall be deducted from the net income of "the taxpayer" for the succeeding taxable year, whereas the statute here does not repeat the term "taxpayer". That is, the statute does not say if the taxpayer has a loss, such loss shall be a carry-over for succeeding taxable years **of the taxpayer.** It takes the position that the failure to expressly repeat the term "the taxpayer" is significant as suggesting that the statute does not limit the right to the carry-over to the person who sustained the loss. Appellant points out that "the right to the carry-over is stated in the passive voice—the statute does not say that, if the taxpayer has a loss **he** shall be entitled to a loss carry-over; that it says only that such loss **shall be** a carry-over". From this appellant argues that Congress was not concerned with who sustained the loss but with the fact of the loss itself, and that it intended to confer the tax benefit thereof to anyone who could associate himself with the loss, such as a successor corporation in a corporate reorganization.

Much is attempted to be made of little. We see no significance in the failure to repeat the term "taxpayer" in the present statute. In providing that if the taxpayer has a loss such loss shall be a carry-over, Congress could only

have meant such carry-over was for the benefit of the taxpayer referred to. Had Congress intended that this right to a loss carry-over be transferable to someone other than the original taxpayer, it would have said so. In **New Colonial Ice Co., Inc., v. Helvering, Commissioner of Internal Revenue,** supra, the Supreme Court said, at page 440:

> "* * * the statutes have disclosed a general purpose to confine allowable losses to the taxpayer sustaining them, **i. e.,** to treat them as personal to him and not transferable to or usable by another.
>
> Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms."

The Supreme Court, in the case of **Interstate Transit Lines v. Commissioner of Internal Revenue,** 1943, 319 U. S. 590, 593, stated:

> "* * * the now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer. **New Colonial Ice Co. v. Helvering,** 292 U. S. 435, 440; **Deputy v. du Pont,** 308 U. S. 488, 493."

In order to obtain credit for the loss carry-over appellant must establish that it is the same "taxpayer" having the net operating loss.

Arriving at the same conclusion, the trial court stated the question herein as follows:

> "* * * is the survivor corporation the same as each of the corporations whose tax credit the merged corporation would appropriate?"

It found that there had been much more than a "comparatively minor change" (**Stanton Brewery, Inc., v. Commissioner of Internal Revenue** (C. A. 2, 1949), 176 F. 2d 573,

575) between the merged corporations and the appellant and concluded:

> "We cannot on this record hold plaintiff and any one of the corporations having either of tax credits in issue, is the same corporation.
>
> "There are far too many differences between the new or survival corporation and each of the old corporations that must fail to survive, to find the corporation surviving is for tax credit purposes the same as the corporations that have ceased to exist."

The trial court further stated:

> "The effect of a ruling such as plaintiff seeks would be establishing a precedent susceptible of wide-spread abuse. That is if Federal courts are to consider themselves bound by state laws and merger agreements under them in tax matters. Such a rule might result in a different Federal tax status for corporations in each state. * * * The law must operate uniformly. It cannot make fish of one and fowl another. And so bankrupt corporations with tax credits would find themselves the object of desirable purchase or 'merger' by or with corporations with tax liabilities, in order that after purchase the tax credits could be used to offset taxes due, just as plaintiff would do in this case. Regardless of what the motive or motives for including the corporations with tax credits in the merger, we have no doubt that use of their tax credits was one. The corporations holding the tax credits could not use them, as apparently the stipulation indicates the stores operated by the corporations having tax credits continued to lose money."

Appellant in this case relies principally upon **Stanton Brewery, Inc., v. Commissioner of Internal Revenue**, supra. The issue there, as stated by the majority opinion, was:

"* * * whether or not, after a merger, the resulting corporation is entitled, in determining its adjusted excess profits net income, to carry over the unused excess profits credit of one of its components for the two years preceding the merger."

The John Stanton Brewing and Malting Company had merged with its wholly owned subsidiary, The Stanton Brewery, Inc. Both were New York corporations and the merger was effected under the New York stock corporation law. The John Stanton Brewing and Malting Company, with its name changed to The Stanton Brewery, Inc., was the surviving corporation. In determining its adjusted excess profits net income for 1942, the surviving corporation deducted the unused excess profits credits of its merged subsidiary for 1940 and 1941. The commissioner disallowed the deduction. The statute therein involved was § 710 (c) (3) (B) of the Internal Revenue Code of 1939, which in part provides:

"* * * If * * * the taxpayer has an unused excess profits credit, such unused excess profits credit shall be an unused excess profits credit carry-over for each of the two succeeding taxable years * * *." 26 U. S. C., § 710 (c) (3) (B).

In considering the purpose of the statute, the court said, at page 574:

"As is well known, Congress sought by the excess profits tax, I. R. C. §§ 710-736, 26 U. S. C. A., §§ 710-736—imposed in 1940 and repealed in 1945—to capture for the government the amount of corporate profits of any one year which were excessive in relation to the like receipts during an earlier or base period (normally 1936-1939). But it was considered equitable that lean years should be set off against lush ones to strike some sort of average, and hence we have the device of the 'unused excess profits credit carry-back and carry-over' from one tax year to another."

The court held therein that since the successor corporation became directly liable under the laws of the State of New York for outstanding debts of the merged corporation, it should be deemed to be the same "taxpayer" as the merged corporation for purposes of applying the carry-over provision. It said that the successor corporation was a "* * * union of component corporations into an all-embracing whole which absorbs the rights and privileges, as well as the obligations, of its constituents," by operation of state law and accordingly was the "taxpayer" presently obligated to pay their taxes and entitled to their credits under the federal tax law.

The court stated, at page 577:

> "Our conclusion that petitioner is entitled to the unused excess profits credit carry-overs of its component corporations seems to us, therefore, the reasonable interpretation of the statutory language. Moreover it seems to us **the one which will carry out the evident statutory purpose, since it accords the privileges of the carry-over provisions to what is essentially a continuing enterprise,** entitled to all their benefits in ameliorating otherwise harsh tax consequences of fluctuating profits or expanding business." (Emphasis supplied.)

In a strongly dissenting opinion in the **Stanton** case, Judge Learned Hand stated, at page 578:

> "A statute so intricate and detailed as this leaves little latitude for interpretation. Moreover, I do not think that it is more consistent with any declared purpose that I can find, to extend the privilege of a 'carry-over' to the taxpayer at bar. Indeed, as the decisions cited in my brothers' opinion show, privileges, closely akin in purpose to this, are ordinarily lost by transfers by one corporation to another; and the form of the transfer cannot be important. We have no war-

rant for supposing that Congress in general regards such credits as parts of a 'universitas juris,' passing, with the chattels, choses in action and the rest, like good-will or trade marks."

Without taking issue with the majority's opinion in the **Stanton** case, we point out that it is distinguishable on its facts. The **Stanton** case involved the merger of one operating corporation and a parent holding company. The business carried on after the merger was substantially the same as that which had theretofore been carried on by the merged operating corporation, and without the merger the latter would have been entitled to the claimed carry-over. The majority opinion refers to the fact that the privilege of the carry-over is accorded to what they refer to as "essentially a continuing enterprise."

In the case before us, we do not have "essentially a continuing enterprise." We are concerned with the merger of seventeen corporations, each of them operating an individual enterprise. Sixteen of the corporations operated sixteen individual stores in sixteen different places, four of them in Illinois and the remainder in Missouri. The seventeenth corporation provided supervisory and managerial services for the other sixteen. The appellant here is attempting to pool seventeen separate enterprises and level the ups and downs of their economic fortunes. We can see no distinction (except corporation as opposed to individual) between the situation confronting us in this case and that in which seventeen individuals, each owning and operating a separate and distinct business, trying to pool their resources and liabilities into one ownership and thereby attempting to take credit for the loss carry-overs of three of the individuals whose enterprises had not returned a profit in the years prior to the combined ownership. The rule contended for by appellant would obviously give unfair advantage to corporations over individuals.

Uniformity of administration of tax laws should be assured all taxpayers.

It is argued that all of the outstanding stock of each of the corporations was owned directly or indirectly by the same individuals and in the same proportions, and that those stockholders have a like interest in the merged corporation, the appellant herein. In other words, we are asked to look behind the corporate fiction of the true owners, the stockholders.

In dealing with a somewhat similar contention, the Supreme Court in **New Colonial Ice Co., Inc., v. Helvering,** supra, stated, at page 441:

> "Thus the contention that the two corporations were practically the same entity and therefore the same taxpayer has no basis, unless, as the petitioner insists, the fact that the stockholders of the two corporations were substantially the same constitutes such a basis.
>
> "As a general rule a corporation and its stockholders are deemed separate entities (**Pullman Car Co. v. Missouri Pacific Ry. Co.**, 115 U. S. 587, 596-597; **Donnell v. Herring-Hall-Marvin Safe Co.**, 208 U. S. 267, 273; **United States v. Delaware, L. & W. R. Co.**, 238 U. S. 516, 527-529; **Cannon Mfg. Co. v. Cudahy Co.**, 267 U. S. 333; **Klein v. Board of Supervisors**, 282 U. S. 19, 24) and this is true in respect of tax problems. (**Klein v. Board of Supervisors**, 282 U. S. 19, 24; **Dalton v. Bowers**, 287 U. S. 404, 410; **Burnet v. Clark**, 287 U. S. 410, 415; **Burnet v. Commonwealth Improvement Co.**, 287 U. S. 415, 418-420.)"

Page 437:

> "The question presented is—where all the assets and business of an older corporation are taken over by a new corporation, specially organized for the purpose and having substantially the same capital structure,

in exchange for a portion of its stock, which is distributed by the older corporation among the latter's stockholders share for share, thereby retiring the old shares, is the new corporation entitled, notwithstanding the change in corporate identity and ownership, to have its taxable income for the succeeding period computed and determined by deducting from its net income for that period the net losses sustained by the older corporation in the preceding period?"

Page 439:

"The petitioner insists that **the continuity of the business was not broken** by the transfer from the old company to the new; and this may be conceded. But it should be observed that this continuity was accomplished by deliberate elimination of the old company and substitution of the new one. Besides, **the matter of importance here, as will be shown presently, is not continuity of business alone but of ownership and tax liability as well.** Had the transfer from one company to the other been effected by an unconditional sale for cash there would have been continuity of business, but not of ownership or tax liability." (Emphasis supplied.)

"Petitioner also insists that the ultimate parties in interest—stockholders and creditors—were substantially the same after the transfer as before; and this may be conceded. But there is here no effort to tax either creditors or stockholders."

Page 440:

"* * * but the statutes have disclosed a general purpose to confine allowable losses to the taxpayer sustaining them, i. e., to treat them as personal to him and not transferable to or usable by another."

"When § 204 (b) is read with the general policy of the statutes in mind, as it should be, we think it can-

not be regarded as giving any support to the deduction here claimed. It brings into the statutes an exceptional provision declaring that where for one year 'any taxpayer has sustained a net loss' the same shall be deducted from the net income of 'the taxpayer' for the succeeding taxable year; and, if such loss be in excess of the income for that year, the excess shall be deducted from the net income for the next succeeding taxable year. Its words are plain and free from ambiguity. Taken according to their natural import they mean that the taxpayer who sustained the loss is the one to whom the deduction shall be allowed. Had there been a purpose to depart from the general policy in that regard, and to make the right to the deduction transferable or available to others than the taxpayer who sustained the loss, it is but reasonable to believe that purpose would have been clearly expressed."

Appellant herein would avoid the import of the **New Colonial Ice** case by directing attention to the fact that that case did not involve a statutory merger of corporations and the instant case does. Appellant accordingly believes that the **Stanton** case is authority for its contention and that the **New Colonial Ice** case is not in point. As we have previously indicated, however, there is factual difference between the instant case and **Stanton.** That is true as to **New Colonial Ice** as well. It does not, however, detract from the force of the Supreme Court's statements in **New Colonial Ice,** supra, and that "* * * the matter of importance here * * * is not continuity of business alone but ownership and tax liability as well."

In tracing the identity of the "taxpayer", it would appear that the Supreme Court was concerned with both continuity of ownership and continuity of business. In the instant case we have seventeen separate businesses

now merged into one. We are of the opinion that this case lacks both of the essential elements necessary to establishing the appellant as the "taxpayer" entitled to the deduction. There is here neither continuity of ownership nor continuity of business.

While we do not consider it as a logical argument against the appellant's position and is, after a fashion, arguing backwards, it is nevertheless pointed out that to allow the credit here would produce a most unusual result. It would mean that **the merger** of these corporations **and the merger alone** would be responsible for the appellant obtaining the credit sought, for if the three corporations sustaining the loss had not merged they would not have been able to take credit for the loss carry-over as they continued to sustain losses. Thus the appellant here is seeking solely by virtue of the merger of the corporations to obtain a benefit which would not have been available to the individual corporations themselves. The income against which appellant seeks to offset the loss did not come from the same business enterprises which gave rise to the loss. Congress intended by the statute involved to level out the ups and downs of **individual business enterprises, not combinations thereof** owned by different taxpayers.

Since this case was argued there has been called to our attention a case of the United States Court of Appeals for the Ninth Circuit, **E. & J. Gallo Winery, a Corp., Petitioner, v. Commissioner of Internal Revenue**, No. 14,180, decided November 9, 1955. That case involved a statutory merger of two corporations under the laws of California. The facts disclosed in the opinion do not indicate whether or not there was involved a continuing enterprise, that is, "continuity of business." The court therein distinguished the case before it from the **New Colonial Ice** case on the ground that in the **Gallo** case there was a true statutory merger and in the **New Colonial Ice** case "there was noth-

ing resembling a merger." Relying strongly on the **Stanton** case, the court said, page 8:

> "We hold and **Stanton** held, that the surviving corporation is the 'taxpayer,' who may use the unused excess profits tax credit of the former corporation."

Apparently the **Gallo** and **Stanton** cases stand on the same footing. Nevertheless, insofar as it can be said that they are parallel with the instant case, we must conclude that they are not persuasive.

Appellant also cites in support of its contention **Helvering, Commissioner of Internal Revenue, v. Metropolitan Edison Co.**, 1939, 306 U. S. 522. In that case the court stated at page 523:

> "These cases present the question whether, under the Revenue Acts of 1926 and 1928, a Pennsylvania corporation may deduct unamortized bond discount and expense in connection with redemption of the bonds of a subsidiary, all of whose assets it had previously acquired pursuant to local law."

That case holds that where a transferee corporation becomes liable for the debts of the transferor because of a merger, it may deduct losses or expenses arising out of the assumed debts, such as unamortized discount on bonds issued by the transferor. That is not the situation confronting the court in this case. The appellant here is not attempting to deduct a post-merger expense or loss of its own arising out of the assumption of the debts of the merged corporations, but to carry over and deduct pre-merger operating losses of three of the merged corporations. Furthermore, in the **Metropolitan Edison** case, the Supreme Court stated at page 529:

> "It is important to note, however, that amongst the liabilities assumed were bonds on which the parent company was already liable as guarantor."

We do not consider **Metropolitan Edison** as authority for appellant's contention.

It is significant, in drawing fact distinctions between the case at bar and those relied on by the appellant, that the merged corporations in the present instance were not all of the same state. Of the three corporations which sustained losses which the appellant is attempting to take as net operating loss carry-overs, two of such corporations were from the State of Illinois and one from the State of Missouri. We find it particularly difficult to say that two legal entities brought into existence by the laws of the State of Illinois are now identical with and have become a creature brought into existence by the laws of Missouri.

In **Newmarket Mfg. Co. v. United States** (D. C. Mass., 1955), 130 F. Supp. 706, the court had before it a situation almost on all fours with that confronting this court. There a Massachusetts corporation had caused the organization of a Delaware corporation. Subsequently the Massachusetts corporation was merged into and consolidated with the Delaware corporation. The consolidated corporation became liable for all the obligations of the Massachusetts corporation. It had the same business as the Massachusetts corporation, the same officers, the same stockholders and the same outstanding stock certificates. After the merger, the Massachusetts corporation ceased to exist as a separate corporation. The question there was whether, under §122 of the Revenue Code of 1939, as amended, 26 U. S. C. A., §122, "* * * a net operating loss incurred by the consolidated corporation in its fiscal year December 1, 1951, to November 30, 1952 (that is, after the merger) may be carried back to be deducted from the income tax liability attributable to the separate operations of the Massachusetts corporation for the period * * *" before the merger.

In a well-reasoned opinion, the court therein stated, at page 707:

"Where identity between the merging corporations and the consolidated corporation is recognized by local law, then, so the argument runs, the federal tax law accepts the identity. Indeed, it is said, such identity has been recognized in connection with carry-back provisions, **Moldit, Inc., v. Jarecki**, D. C. N. D. Ill., Aug. 13, 1953 (P. H. par. 72, 681), as well as in connection with unused excess profits credits. **Stanton Brewery, Inc., v. Commissioner**, 2 Cir., 176 F. 2d 573.

"There are two fundamental vices in this argument. First is the erroneous assumption that the federal tax law determines the identity of the taxpayer under federal law by reference to state rules of law or private agreements governing mergers. However, the question whether the same taxpayer is involved in two different accounting periods under federal law is to be decided exclusively by federal tax law. Second is the fallacious proposition that the Delaware corporation is the same person as the Massachusetts corporation merely having, as plaintiff's brief contends, another domicil and another name. However, even if the situation at bar involved two corporations chartered by the same state it would not be true that the identity of one corporation survives when merged with another."

The court held:

"* * * that under §122 of the Internal Revenue Code of 1939 a consolidated corporation cannot carry back its losses in one year to reduce the tax liability incurred in an earlier year due to operations of one of its constituent corporations."

When Congress passed the statute here involved it was concerned with eliminating inequality, taxwise, between a business with alternating profit and loss as compared with

a business with stable profits. It allowed the lean years of a business with alternating profit and loss to be set-off against the good years so as to strike an equitable tax liability as compared to a business having steady profits. We find nothing to suggest that Congress intended that a number of individual enterprises could pool their economic ups and downs and thus level off their tax burden between them. Congress was concerned with the economic fortunes of individual taxpayers, not combinations thereof.

Affirmed.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

2. Text of Statutes Involved:

Section 23 (s), Internal Revenue Code of 1939:

"Deductions from gross income. In computing net income there shall be allowed as deductions: * * *

(s) Net operating loss deduction. For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122" (26 U. S. C., Sec. 23 (s).

Section 122(b) (2) (C), Internal Revenue Code of 1939, as amended by Revenue Act of 1951, 65 Stat. 452, effective for taxable years beginning after December 31, 1948:

"Net operating loss deduction.

* * * * * * * *

(b) Amount of carry-back and carry-over.

* * * * * * * *

(2) Net operating loss carry-over.

* * * * * * * *

(C) Loss for taxable year beginning after December 31, 1947, and before January 1, 1950. If for any tax-

able year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years computed—

(i) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and

(ii) by determining the net operating loss deduction for each intervening taxable year without regard to such net operating loss or to the net operating loss for any succeeding taxable year and without regard to any reduction specified in subsection (c).

"For the purpose of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1947, and before January 1, 1950, shall be reduced by the sum of the net income for each of the two preceding taxable years computed—

(iii) with the exceptions, additions and limitations provided in subsection (d) (1), (2), (4), and (6), and

(iv) by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year, and without regard to any reduction specified in subsection (c)" (26 U. S. C., Sec. 122 [b] [2] [C] [1952]).

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

No. 64.

LIBSON SHOPS, INC.,
Petitioner,

v.

GUSTAVE F. KOEHLER, District Director
of Internal Revenue.

On Writ of Certiorari to the United States Court
of Appeals for the Eighth Circuit.

PETITIONER'S BRIEF ON THE MERITS.

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INDEX.

	Page
Opinions below	1
Jurisdiction	1
Statutes Involved	2
Question Presented	2
Statement of the Case	2
Summary of Argument	6
Argument:	
I. The Problem in its Legislative Setting	8
A. The Statutes Involved	8
1. Petitioner includes each of the merged corporations.	
2. Petitioner through the merger achieved the tax status of each of the merged corporations.	
B. Related Legislation	16
II. The Problem before the Treasury and in the Courts	19
A. The Government's Position in Cases of Statutory Merger	19
B. The Recent Cases	25
III. The Court of Appeals' Opinion	27
Conclusion	35
Appendix:	
(i) Statutes Involved	37
(ii) Historical Note	39
(iii) State Statutes Governing Merger	40

TABLE OF CITATIONS.

Cases:

Adrian & James, Inc., 4 T. C. 708 (1945) 16
Alaska Salmon Co., 39 B. T. A. 455 (1939) 15
Alprosa Watch Corporation, 11 T. C. 240 (1948) 33
Argenbright v. Phoenix Finance Co. of Iowa, 21 Del. Ch. 288, 187 A. 124 (1936) 11
Aspinook Corp. v. Commissioner, 326 Mass. 327, 94 N. E. (2d) 366 (1950) 11
Athol Mfg. Co. v. Commissioner, 54 F. (2d) 230 (1st Cir., 1931) 32
Bazley v. Commissioner, 331 U. S. 737 (1947) 13
Bowman Hotel Corporation, 24 B. T. A. 1193 (1931) .. 15
California Casket Co., 19 T. C. 32 (1952) 20
Dodier Realty and Investment Co. v. St. Louis National Baseball Club, 238 S. W. (2d) 321 (Mo., 1951) 11
E. & J. Gallo Winery v. Commissioner, 12 T. C. M. 414, rev'd 227 F. (2d) 699 (9th Cir., 1955) 7, 9, 18, 20, 24, 25, 27, 32
Griffiths v. Commissioner, 308 U. S. 355 (1939) 13
Helvering v. Metropolitan Edison Co., 306 U. S. 522 (1939) 6, 12, 22, 23, 29, 31, 32
Koppers Coal Co., 6 T. C. 1209 (1946) 16
Koppers Company, Inc., v. United States, 134 F. Supp. 290 (Ct. of Claims, 1955) .. 6, 7, 15, 16, 18, 20, 23, 25, 26, 27
Lewyt Corp. v. Com., 349 U. S. 237 (1955) 28
Moldit, Inc., v. Jarecki, 53-2 U. S. T. C. ¶ 9551 (D. C. Ill., N. D., 1953), appeal dis'd pursuant to stip. (7th Cir., July 26, 1954) 21
Morrisdale Coal Mining Co., 19 T. C. 208 (1952) 23
Mutual Building and Loan Association of Pasadena v. Wiborg, 59 Cal. App. (2d) 325, 139 P. (2d) 73 (1943) 12
New Colonial Ice Co. v. Helvering, 292 U. S. 435 (1934) 7, 20, 21, 22, 23, 28, 30, 33

Newmarket Mfg. Co. v. United States, 233 F. (2d) 493 (1st. Cir., 1956) 7, 9, 21, 25, 26, 27, 31
Northway Securities Co., 23 B. T. A. 532 (1931) 33
Oswego Falls Corporation, 26 B. T. A. 60 (1932), aff'd 71 F. (2d) 673 (2d Cir., 1934) 14
Phillips v. Howe Films Co., 33 F. (2d) 891 (3d Cir., 1939) 16
Reo Motors v. Commissioner, 338 U. S. 442 (1950) ... 8
A. D. Saenger, 38 B. T. A. 1295 (1938) 14
Standard Paving Co. v. Commissioner, 13 T. C. 425 ..21, 23
Stanton Brewery, Inc., v. Commissioner, 11 T. C. 310 (1948), rev'd 176 F. (2d) 573 (2d Cir., 1949) 6, 7, 11, 15, 18, 19, 20, 21, 23, 24, 25, 26, 30, 32, 33
Trahern Pump Company, 27 B. T. A. 363 (1932) 15
Turner-Farber-Love Co. v. Helvering, 68 F. (2d) 416 (D. C. Cir., 1933) 32
U. S. v. Seattle-First National Bank, 321 U. S. 583 (1944) 29

Statutes:

Act of July 15, 1947, c. 249, 61 Stat. 324 17
California Civil Code (1943), § 361 12
Delaware General Corporation Law, § 60 (Delaware Code of 1953, § 259) 11
Illinois Business Corporation Act, Laws 1933, p. 310 (Ill. R. S., c. 32, § 157):
Sec. 61 10
Sec. 67 10
Sec. 69 10
Sec. 69 (a), (b), (d) 10
Sec. 69 (e) 14
Internal Revenue Code of 1939:
Sec. 23 (s) 2, 8, 9
Sec. 112 (b) 21
Sec. 122 .....2, 6, 8, 9, 26, 27, 33
Sec. 122 (b) (2) (C) 9, 14, 20, 26

Sec. 129 33
Sec. 272 (a) (1) 15
Sec. 710 (c) (3) (B) 20, 25, 26
Sec. 742 ..... 20, 25
Sec. 3797 (a) (14) 9
Internal Revenue Code of 1954, § 381 ..... 6, 18
Missouri General and Business Corporation Act, Laws 1943, p. 410 (Mo. R. S. 1949, c. 351):
Sec. 62 10
Sec. 68 10
Sec. 70 10
Sec. 70 (e) 14
Revenue Act of 1918, § 204 (b), c. 18, 40 Stat. 1057 .. 13, 28

Miscellaneous:

Brief for the Respondent in Opposition, Standard Paving Co. v. Commissioner, cert. den., 342 U. S. 80 (1951) 21
Brief for the United States, filed April 29, 1955, Koppers Company, Inc., v. United States, 134 F. Supp. 290 (Ct. of Claims 1955) 23
Fletcher, Cyc. Corp. (Perm. ed.), § 7041 11
Griswold, Note, 56 Harv. L. Rev. 1142 (1943) 28
H. R. Rep. No. 871, 78th Cong., 1st Sess. 33
H. R. Rep. No. 624, 80th Cong., 1st Sess. 17
H. R. Rep. No. 1337, 80th Cong., 2d Sess. 18, 19
Mim. 5957, 1945 Cum. Bull. 181 21
P. S. No. 62, 1950 CCH Standard Fed. Tax Rep. par. 6118, Petition for certiorari, filed June 28, 1956, U. S. v. Newmarket Mfg. Co., No. 216, October Term, 1956 7
S. Rep. No. 617, 65th Cong., 3d Sess. 6, 13
S. Rep. No. 627, 78th Cong., 1st Sess. 33
S. Rep. No. 1622, 83d Cong., 2d Sess. 18, 19

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

No. 64.

LIBSON SHOPS, INC.,
Petitioner,

v.

GUSTAVE F. KOEHLER, District Director
of Internal Revenue.

On Writ of Certiorari to the United States Court
of Appeals for the Eighth Circuit.

PETITIONER'S BRIEF ON THE MERITS.

OPINIONS BELOW.

The opinion of the District Court (R. 32) is reported at 55-1 U. S. T. C., paragraph 9458. The opinion of the Court of Appeals (R. 47) is reported at 229 F. (2d) 220.

JURISDICTION.

The jurisdiction of this Court has been invoked under the Act of June 25, 1948, c. 646, 62 Stat. 928, 28 U. S. C., section 1254 (1), by petition for writ of certiorari alleging

a conflict between the decision of the Court of Appeals in this case and the decisions of other Courts of Appeals on the same matter. The judgment of the Court of Appeals was entered January 19, 1956. (R. 61.) An order denying petitioner's petition for rehearing was entered February 16, 1956. (R. 61.) The petition for a writ of certiorari was filed April 14, 1956. The order granting certiorari was entered June 4, 1956, by this Court. (R. 62.)

STATUTES INVOLVED.

The statutes involved are sections 23 (s) and 122 of the Internal Revenue Code of 1939, as amended and in force at the relevant time. 26 U. S. C. (1952 ed.), sec. 23, 122. The pertinent text of these statutes is set forth in the Appendix, infra, pp. 37-~~41~~ 39.

QUESTION PRESENTED.

The question presented is whether the petitioner, as the surviving corporation in a statutory merger of seventeen (17) corporations under the laws of Missouri and Illinois, in computing its net income for its first taxable period commencing after the date of the merger, is entitled to carry over and deduct net operating losses sustained by three of the merged corporations.

STATEMENT OF THE CASE.

This case is here on certiorari to review the judgment of the Court of Appeals affirming a District Court judgment dismissing petitioner's suit for refund of federal income tax for its taxable year ended July 31, 1950. After elimination of two minor issues at the appellate level, the amount involved is approximately $12,000, plus statutory interest from the date of the disputed overpayment.

Petitioner is a Missouri corporation having its principal office in St. Louis, Missouri (R. 13). It was incorporated January 2, 1946, under the name "Libson Shops Management Corporation" (R. 14). Following incorporation, petitioner provided management services for sixteen other corporations, each of which was incorporated at the same time as petitioner or a short time thereafter to engage in the business of selling women's wearing apparel (R. 14). Of the sixteen sales corporations, twelve were incorporated in Missouri and four were incorporated in Illinois (R. 14).

Prior to August 1, 1949, petitioner's issued and outstanding capital stock consisted of 470 shares of the par value of $100 each, and the issued and outstanding capital stock of each of the sixteen sales corporations consisted of 20 shares of $100 par value each (R. 19-21). Prior to August 1, 1949, all of the stock of the petitioner and of each except one of the sixteen sales corporations was held by eight individuals, six of whom held 14.05 per cent each and two of whom held 7.85 per cent each of the stock of each of said corporations; while all of the stock of the remaining sales corporation was held by one of the other sales corporations (R. 21). Thus all of the outstanding stock of the petitioner and of each of the sixteen sales corporations was owned directly or indirectly by the same persons and among them in the same relative proportions (R. 21).

On July 28, 1949, each of the said corporations executed an Agreement for Statutory Merger (R. 15). The Agreement (R. 18-30) after recitals outlining the corporate history, capital structure and stock ownership of petitioner and of each of the other corporations (R. 19-21), designated petitioner as the surviving corporation in the merger (R. 22); provided for amendment of the petitioner's certificate of incorporation, changing petitioner's corporate

name to "Libson Shops, Inc." (R. 22); and its authorized capital from 1000 shares of $100 par value common stock and 500 shares of $100 par value preferred stock (R. 19) to 20,000 shares of one class of $10 par value each (R. 24); provided for the issuance of 16,000 shares of the new stock of the petitioner to the eight individual stockholders in exchange for their shares in each of the constituent corporations, in the same proportion among them as that in which they held stock, directly or indirectly, in each of the constituent corporations (R. 25); designated the same persons as directors of the surviving corporation as previously had been directors of petitioner and of each of the other constituent corporations (R. 21, 27); adopted as the by-laws of the surviving corporation the by-laws theretofore adopted by petitioner (R. 27); outlined further procedure for placing the Agreement into effect and fixed the effective date of the merger (R. 27); and spelled out certain effects of the merger (R. 28-29).

On August 1, 1949, the merger of the sixteen sales corporations into the petitioner was effected under and in accordance with Section 67 of "The General and Business Corporation Act of Missouri," and Sections 69 (a) and 66 of "The Business Corporation Act" of the State of Illinois (R. 15, 30-32).

At the close of their taxable periods ended July 31, 1949, three of the Libson corporations had unused net operating loss carry-overs for federal income tax purposes, resulting from net operating losses sustained by them in those or prior taxable periods (R. 16).

Petitioner, in computing net taxable income for its taxable year August 1, 1949, to July 31, 1950, deducted $22,432.76, the total of the unused net operating loss carry-overs of the three corporations at July 31, 1949, computed as follows:

Corporation	Taxable Period of Loss	Amount
Evanston Libson Shops, Inc.	Calendar year 1948	$ 8,115.11
	Jan. 1, 1949, to July 31, 1949	6,122.28
Lawrence Libson Shops, Inc.	Jan. 1, 1948, to July 31, 1948	245.03
	Fiscal year ended July 31, 1949	2,770.42
Hampton Libson Shops, Inc.	Fiscal year ended July 31, 1949	4,879.92
	Total	$22,432.76

The deduction of $22,432.76 was disallowed in full by the Commissioner of Internal Revenue, who, on May 21, 1953, issued a statutory notice of deficiency (R. 14). On June 6, 1953, petitioner paid to the respondent herein the amount of the deficiency plus interest (R. 14) and on August 13, 1953, filed claim for refund of that amount (R. 17, 6-11). On March 16, 1954, the Commissioner disallowed the claim (R. 18).

On April 2, 1954, petitioner filed suit in the District Court to recover the amount so claimed. On April 15, 1955, the District Court entered its judgment dismissing petitioner's suit. On June 13, 1955, petitioner appealed to the Court of Appeals with the result above-stated.

SUMMARY OF ARGUMENT.

Petitioner is entitled to the carry-over under section 122 of the Internal Revenue Code of 1939 because it is the "taxpayer" with respect to the losses of each of the merged corporations. This follows from the applicable Missouri and Illinois statutes, which reflect the familiar concept of a statutory merger, under which the surviving corporation absorbs each of the others and inherits their rights and obligations. **Helvering v. Metropolitan Edison Co.**, 306 U. S. 522 (1939). Moreover, the statute, construed in the light of the original purpose of the net operating loss carry-over provisions it contains, allows the carry-over to a corporation standing in the tax shoes of the corporation having the loss. S. Rep. No. 617, 65th Cong., 3d Sess. The petitioner as the surviving corporation in a statutory merger stands in just such a position with respect to each of the merged corporations. It is a well-settled rule of federal tax cases, that the surviving corporation being primarily and not derivatively liable for the taxes of each merged corporation, it is to be treated as the same corporation for other tax purposes. **Stanton Brewery, Inc. v. Commissioner**, 176 F. (2d) 573 (2d Cir., 1949).

This construction of section 122 is consistent with Congress' historical attitude toward the tax significance of corporate reorganization, manifested most recently by section 381 of the 1954 Internal Revenue Code, which expressly allows the carry-over in a case such as this, as well as in other reorganizations. See **Koppers Company, Inc., v. United States**, 134 F. Supp. 290 (Ct. of Claims, 1955). (Whether the carry-over under the 1939 Code extends to successor corporations in tax-free reorganizations other than statutory mergers is a broader question than that here involved. There is a clear distinction between the continuity of legal incidents which is characteristic of a

statutory merger and the continuity of economic interests which may be said to be characteristic of tax-free reorganizations generally. Cf. **New Colonial Ice Co. v. Helvering**, 292 U. S. 435 [1934]. While reconsideration of the doctrine of that case may be appropriate, it is not necessary.)

All other appellate authority beginning with the **Stanton Brewery** case, decided in 1949, and continuing without deviation through a series of cases decided in the past year (**Koppers Company, Inc., v. United States**, supra; **E. & J. Gallo Winery v. Commissioner**, 227 F. [2d] 699 [9th Cir., 1955], and **Newmarket Manufacturing Co. v. United States**, 233 F. [2d] 493 [1st Cir., 1956]) supports petitioner's position and conflicts sharply with the decision from which this petition was taken. The Government itself is on record in support of the same position, having held that in cases of statutory merger tax credits of a merged corporation emerge in favor of the survivor. E. g., P. S. 62, 505 CCH Standard Federal Tax Rep., par. 6118. The Government's inconsistency is so startling that petitioner is forced to conclude either that the Government has changed its view in the course of the present litigation or that its real position today is that this case turns upon special facts which distinguish it from the others mentioned, although that position in turn is belied by the Government's petition for certiorari in **United States v. Newmarket Mfg. Co.**, No. 216 in this Court.

The Court of Appeals' opinion herein can only be explained in terms of failure to give proper consideration to the reasonable views expressed in the conflicting cases, or in terms of a mistaken notion that this case has features which set it apart from the others. The Court relies upon **New Colonial Ice Co. v. Helvering**, supra, although that case is clearly distinguishable, and it fails to give effect to **Helvering v. Metropolitan Edison Co.**, supra, although the latter in principle is controlling.

ARGUMENT.

I. THE PROBLEM IN ITS LEGISLATIVE SETTING.

A. The Statutes Involved.

The statutes involved are sections 23 (s) and 122 of the Internal Revenue Code of 1939. A brief history of their origin and amendment is contained in the Appendix, infra, pp. 37-39.

Section 23 (s) provides that in computing net income there shall be allowed "the net operating loss deduction computed under Section 122."

Section 122 consists of subsections (a) to (e); (a) defines "net operating loss" as the excess of allowable deductions over gross income, with certain qualifications. Of course, where deductions exceed gross income for a given taxable year, there is no net income subject to tax for that year, so that a "net operating loss" can have no tax significance for the year of loss. The essence of the statute, therefore, is to be found in subsections (b) and (c), which provide for determination of the amount of "carry-back" and "carry-over" and the amount of net operating loss deduction, i. e., they provide that the net operating loss for a given taxable year may be deducted (i) in computing taxable income of preceding years (a "carry-back") and (ii) to the extent not required to absorb income of the carry-back years, in computing taxable income of succeeding years (a "carry-over"). See **Reo Motors v. Commissioner**, 338 U. S. 442, 446 (1950).

Subsection (d) of 122 contains certain exceptions and limitations which are applicable in determining the loss, the carry-back or carry-over and the deduction, but none

of these is material here, and subsection (e) is not material here.

Petitioner claims a net operating loss deduction in the amount of the aggregate net operating loss carry-overs of the Evanston, Lawrence and Hampton corporations. It is not disputed that 23 (s) allows the deduction if it is properly computed under 122, or that the amount of the deduction is properly computed under 122 (c) if the petitioner is entitled to the carry-overs under 122 (b). Inasmuch as all of the losses here involved were sustained during the period covered by 122 (b) (2) (C), this is the portion of the statute which is the object of particular concern.

122 (b) (2) (C) provides in applicable part as follows:

> "If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years. . . ."

The statute furnishes "no explicit guidance for the problem at hand." **Newmarket Manufacturing Co. v. United States**, 233 F. (2d) 493, 496 (1st Cir., May 18, 1956). In this situation the Government has sought the answer in terms of a mechanical application of the term "taxpayer," contending that petitioner is not the "taxpayer" which sustained the loss. Brief for the Respondent in Opposition, p. 5. Cf. **E. & J. Gallo Winery v. Commissioner**, 227 F. (2d) 699, 704 (9th Cir., 1955), and **Newmarket Mfg. Co. v. U. S.**, supra, p. 496, where similar reasoning was noted and rejected as unsound.[1]

Petitioner on the other hand contends, first, that even adopting this literal approach it is the "taxpayer," be-

[1] Compare also the general Code definition, "'taxpayer' means any person subject to a tax . . ." I. R. C. 1939, sec. 3797 (a) (14); 26 U. S. C. (1952 ed.), sec. 3797.

cause the surviving corporation in a statutory merger includes each of the merged corporations; and, secondly, that construing the statute in the light of its purpose, petitioner is entitled to the carry-overs because, tax-wise, it stands in the same position as each of the merged corporations.

1. Petitioner includes each of the merged corporations.

The merger was accomplished under the laws of Missouri and Illinois.[2] Both provide that domestic corporations and foreign corporations may merge in accordance with a prescribed procedure, which was followed here (R. 15). The provisions dealing with the effect of merger upon the status, rights and interests of the merging corporations are identical. They are as follows:

> "(a) The several corporations parties to the plan of merger or consolidation shall be a single corporation. . . . (b) The separate existence of all corporations parties to the plan of merger or consolidation, except the surviving or new corporation, shall cease. . . . (d) Such surviving or new corporation shall thereupon and thereafter possess all the rights, privileges, immunities and franchises, as well of a public as of a private nature, of each of the merging or consolidating corporations; and all property . . . and all and every other interest, of . . . each of the corporations so merged or consolidated, shall be taken and deemed to be transferred to and vested in such single corporation without further act or deed; . . ." Missouri Act, sec. 70; Illinois Act, sec. 69.

These provisions operate to continue each of the merging corporations within the framework of one, the nom-

[2] The General and Business Corporation Act of Missouri, Laws 1943, p. 410, secs. 62, 68, 70, Mo. R. S. 1949, secs. 351.410, 440, 450; The Business Corporation Act of Illinois, secs. 61, 67, 69, 69a, Ill. R. S., c. 32, sec. 157. The pertinent text is set forth in the Appendix, infra, pp. 40-44.

inal survivor. The merging corporations "shall be" a single corporation, i. e., the several are blended into one, and it is only the "separate" existence of the others which ceases. The rights and interests are "deemed to be" transferred, i. e., they pass not by transfer, but by operation of law. **Dodier Realty and Investment Co. v. St. Louis National Baseball Club**, 238 S. W. (2d) 321 (Mo., 1951).

This construction of the Missouri and Illinois statutes is in accord with the generally recognized concept of statutory merger, as effecting the "absorption" of the merging corporations by the nominal survivor. **Fletcher, Cyc. Corp.** (Perm. Ed.), sec. 7041. The concept has been expressed in various ways.

Thus, with reference to a merger under the General Corporation law of the State of Delaware,[3] it has been said:

> ". . . the old corporations have their identity absorbed into that of the . . . one into which they were merged." **Argenbricht v. Phoenix Finance Co. of Iowa**, 21 Del. Ch. 288, 187 A. 124, 126 (1936).

Another court, interpreting the same statute, said:

> "From the moment of consolidation the 'existence of each of these corporations is to be a combined existence manifested solely through and operating in the name of the consolidated corporation.'" **Aspinook Corp. v. Commissioner**, 326 Mass. 327, 94 N. E. (2d) 366, 368 (1950).

Again, in **Stanton Brewery, Inc., v. Commissioner**, 176 F. (2d) 573 (2d Cir., 1949), the court, speaking of a merger under New York law, said:

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[3] Now Title 8, Del. Code of 1953. Like the Missouri and the Illinois statutes, section 60 of the Delaware law involved in the *Argenbricht* case covered both consolidation and merger and provided that as a result of either "the *separate* existence . . . shall cease . . ." See Del. Code of 1953, sec. 259.

> "... we must regard the 'resulting corporation' as the union of component corporations into an all-embracing whole which absorbs the rights and privileges, as well as the obligations, of its constituents." 176 F. (2d) 575.

With reference to a merger under the Civil Code of California[4] it has been said:

> "... the separate corporate existence [of the merging corporation] suffered the fate of all merged corporations ... became a part of the muscle and blood stream of the mergee corporation. ... While the ... merger ... caused it to lose its identity as to its separate existence, yet it became an integral part [of the surviving or 'mergee' corporation]." **Mutual Building and Loan Association of Pasadena v. Wiborg**, 59 Cal. App. (2d) 325, 328, 329, 139 P. (2d) 73, 74, 75 (1943).

Or as this Court has put it:

> "... the corporate personality of the transferor is drowned in that of the transferee." **Helvering v. Metropolitan Edison Company**, 306 U. S. 522, 529.

No matter how grim the metaphor, the idea is the same: In a statutory merger the surviving corporation alone continues its nominal existence, but it includes each of the merged corporations. Therefore, the petitioner is the "taxpayer" under the statute.

2. Petitioner through the merger achieved the tax status of each of the merged corporations.

The application of the language of a revenue provision such as section 122 "is not an exercise in framing ab-

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[4] Section 361 of the Code, in effect at the time the cited case was decided, provided that the merging corporations "shall be one corporation" and that "the separate existence of the constituent corporations shall cease, except that of the surviving corporation."

stract definitions." **Bazley v. Commissioner**, 331 U. S. 737, 741 (1947). "Legislative words are not inert, and derive vitality from the obvious purposes at which they are aimed." **Griffiths v. Commissioner**, 308 U. S. 355, 358 (1939).

The purpose of the carry-over appears from the legislative history of the first such provision in section 204 (b), Revenue Act of 1918, c. 18, 40 Stat. 1057, which finds Congress recognizing that the principle of strict annual tax accounting is at odds with the law's essential scheme of taxing net income:

> "At the present time no recognition is given to net losses; that is, if in any year the losses and expenses of a taxpayer exceed his gross income the excess (or, in other words, the net loss) cannot be carried over into the next year. For purposes of taxation the settlement must be made upon the basis of each year's business by itself. The chief merit of the present plan is its simplicity of administration. But it does not adequately recognize the exigencies of business, and, under our present high rates of taxation, may often result in grave injustice." S. Rep. No. 617, 65th Cong., 3d Sess., 1939-1 Cum. Bull. (Part 2) 121-122.

In other words, prior to the 1918 Act, if a person subject to income tax had income in excess of deductions in a given year, he was required to pay a tax, but if his deductions exceeded his income for the same year, the Government made no corresponding concession. The slate was wiped clean, the excess deductions lost all tax significance at the close of the year, and "income," the subject of tax, lost contact with economic reality.

This was the condition which the first carry-over provision was designed to remedy, and which, therefore,

should be considered in construing subsequent versions including the present statute. When section 122 (b) (2) (C) provides that loss for a given year may be considered in computing taxable income of succeeding years, it is intended to neutralize the liability for tax which would have attached had there been net income in the given year. So construing the statute, its benefits reasonably extend to one against whom such liability would have attached, and it remains only to demonstrate that petitioner, following the merger, was subject to tax for the years of loss to the same extent and in precisely the same sense as were the Evanston, Lawrence and Hampton corporations prior to the merger.

The applicable Missouri and Illinois statutes both provide that upon merger the surviving corporation "shall thenceforth be responsible and liable for all the obligations of each" of the merging corporations, and that any claim against any merging corporation may be enforced, "as if such merger . . . had not taken place. . . ." Missouri Act, section 70 (e); Illinois Act, section 69 (e).

That the obligations referred to include federal income tax liabilities of the merging corporations is clear from cases dealing with consolidations given similar effect under statutes of other states. **Oswego Falls Corporation,** 26 B. T. A. 60 (1932), aff'd, 71 F. (2d) 673 (2d Cir., 1934); **A. D. Saenger,** 38 B. T. A. 1295 (1938).[5] The cited cases hold that the emerging corporation is primarily liable as "the taxpayer" and not as a transferee (26 B. T. A. 72;

[5] The *Oswego Falls* case involved a New York statute which, as set out in the opinion of the Board of Tax Appeals, provided ". . . such new corporation shall succeed to and be held liable to pay and discharge all such debts and liabilities of each of the corporations consolidated in the same manner as if such new corporation had itself incurred the obligation or liability to pay such debt or damages . . ." 26 B. T. A. 70. The statute involved in the *Saenger* case is likewise set out in the opinion and was described by the Board as substantially the same as the New York statute. 38 B. T. A. 1301.

38 B. T. A. 1302), a rule which has been confirmed by subsequent authority. **Stanton Brewery, Inc., v. Commissioner,** supra, pp. 575, 576; **Koppers Company, Inc., v. United States,** 134 F. Supp. 290, 295 (Ct. of Claims, 1955).

This rule in turn has been applied in a line of decisions holding that for other tax purposes the successor corporation in a statutory merger or consolidation stands in the shoes of each of its predecessors. Thus, a petition for redetermination of deficiency is within the jurisdiction of the Tax Court where the deficiency is assessed against a merged or consolidated corporation and the petition is filed by the surviving or resultant corporation [**Bowman Hotel Corporation,** 24 B. T. A. 1193 (1931); **Trahern Pump Company,** 27 B. T. A. 363 (1932); **Alaska Salmon Co.,** 39 B. T. A. 455 (1939)[6]] although section 272 (a) (1) of the 1939 Code, which in principle governs the question presented in each of the cases cited, provides that if the Commissioner determines a deficiency "in the case of any taxpayer," he may send a notice thereof "to the taxpayer" and thereafter "the taxpayer" may file a petition for redetermination. I. R. C. 1939, as amended, 26 U. S. C. A. (1955), sec. 272 (a) (1).

The rationale of each of the cited cases is as stated in **Alaska Salmon:**

> "The above statutes of the States of Washington and California, as we read them, provide that in a case like this, where a Washington corporation merges into a California corporation, the effect is that the surviving California corporation becomes primarily liable for the debts of the Washington corporation. The effect is thus exactly like that under the consolidation statutes of New York considered in the **Bow-**

[6] The state statute involved in the *Bowman Hotel* case is the one quoted in note 5 above. The *Trahern Pump* case involved a consolidation of four corporations under Illinois law, here involved.

man Hotel case and under the Illinois statutes in the **Trahern Pump Co.** case. The tax liabilities of the Washington corporation became the liabilities of the California corporation, and a petition filed by the California corporation for redetermination of a deficiency determined against the Washington corporation is within our jurisdiction" 39 B. T. A. 457-458.

Such decisions cannot be dismissed summarily as involving a procedural question. The expressed reason for holding the surviving or resultant corporation to be "the taxpayer" for purposes of contesting a deficiency is that it is "the taxpayer" which would be liable if the deficiency were upheld. Exactly the same reasoning applies here, for petitioner unquestionably would have been primarily liable for any deficiencies assessed against the merged corporations for the loss years. See also **Phillips v. Howe Films Co.**, 33 F. (2d) 891 (3d Cir., 1939); **Adrian & James, Inc.**, 4 T. C. 708 (1945); **Koppers Coal Co.**, 6 T. C. 1209 (1946):

B. **Related Legislation.**

The conclusion that the loss carry-over extends to the surviving corporation in a statutory merger is consistent with Congress' historical attitude toward the tax significance of corporate reorganization.

The trend, as recently noted in **Koppers Company, Inc., v. United States**, supra, has been toward "a more liberal and realistic approach," manifested in various ways:

> ". . . The language of the carry-back and carry-over provisions have been broadened and the years available for leveling out the fluctuations in earnings have been extended. Elaborate corporate reorganization provisions have been inserted in the code liberalizing the tax free exchange provisions to allow non-

> recognition of gain or loss on more transactions and the carry-over of the basis of the old corporation's assets and generally conferring upon the new corporation the same tax status of the old corporation. . . . In tax free reorganizations, the successor corporation is entitled under section 742 to use the average base period net income of its components, with certain adjustments, in determining its excess profits credit. The changes reflect a legislative policy of having tax consequences of tax free reorganizations turn on matters of substance rather than technicality or form. . . ." 134 F. Supp. 296.

In keeping with this "legislative policy," Congress twice has adverted particularly to the problem here involved, and each time has provided that the carry-over of tax benefits is not to be lost in consequence of a corporate reorganization.

The first instance was in the enactment of a statute providing that where property of a railroad corporation is acquired by another railroad corporation in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, the successor is entitled to carry over net operating losses and unused excess profits credits of the predecessor. Act of July 15, 1947, c. 249, 61 Stat. 324, sec. 1.

The Government in a number of cases has argued inferentially from this statute that if Congress had intended a similar result with respect to reorganized corporations generally, it would have said so. But the purpose of the 1947 statute was to insure the carry-over where a new corporation was organized **as well as** where a new corporation was not organized, because **in the former case** it had been held that the successor was not entitled to the carry-overs.[7]

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[7] See H. R. Rep. No. 624, 80th Cong., 1st Sess.

Thus enactment of the 1947 statute is not evidence that Congress regarded new general legislation necessary to cover **the case of statutory merger**, where no new corporation is involved. On the contrary, the legislative history suggests the opposite conclusion. **Stanton Brewery, Inc., v. Com.**, supra, p. 577; **Koppers Co., Inc., v. U. S.**, supra, p. 297; **E. & J. Gallo Winery v. Com.**, supra, p. 706.

Congress again focused upon the problem of carry-overs in corporate reorganizations in the Internal Revenue Code of 1954, when it provided that where all or substantially all the property of a corporation is acquired by another corporation in one of four types of tax-free reorganizations (including a statutory merger), the successor is entitled to carry over certain tax-significant items (including net operating losses) of the predecessor. I. R. C. 1954, sec. 381, 68 A. Stat. 124.

Section 381 of the 1954 Code, taken as a whole, may also be regarded as part of a "statutory scheme" which reflects Congress' continuing realistic approach to the tax consequences of corporate reorganization. **Koppers Company, Inc., v. U. S.**, supra, pp. 296-297. In addition, while the committee reports state that no inference with respect to prior law is to be drawn from the enactment of this statute,[8] the reports themselves indicate Congressional consciousness of the prior-law distinction between statutory merger and other kinds of reorganization:

> "Present practice rests on court-made law which is uncertain and frequently contradictory. Your committee agrees that whether or not the items carry over should be based upon economic realities rather than upon such artificialities as the legal form of the reorganization . . . The new rules enable the successor

[8] H. R. Rep. No. 1337, 83d Cong., 2d Sess. 41; S. Rep. No. 1662, 83d Cong., 2d Sess. 277.

corporation to step into the 'tax shoes' of its predecessor corporation without necessarily conforming to artificial legal requirements which now exist under court-made law. Tax results of liquidations or reorganizations are thereby made to depend less upon the form of the transaction than upon the economic integration of two or more separate businesses into a unified business enterprise." S. Rep. No. 1622, 83d Cong., 2d Sess., p. 52. See also H. R. Rep. No. 1337, p. 41.

Petitioner submits that Congress thus recognized that under prior law it had been held that a carry-over is allowable in a statutory merger (**Stanton Brewery, Inc. v. Com.**, supra), and that the purpose of the new law was to insure allowance of the carry-over in other reorganizations as well.

Congress intends that successor corporations generally be enabled to "step into the 'tax shoes' " of their predecessors; the surviving corporation in a statutory merger stands in the tax shoes of each merged corporation under the law as it existed prior to enactment of the 1954 Code.

II. THE PROBLEM BEFORE THE TREASURY AND IN THE COURTS.

A. The Government's Position in Cases of Statutory Merger.

The history of the present question in the appellate courts begins with the case of **Stanton Brewery, Inc., v. Commissioner**, 11 T. C. 310 (1948), rev'd 176 F. (2d) 573 (2d Cir., 1949). On December 31, 1941, a wholly-owned subsidiary merged into its parent company under New York law. In determining its adjusted excess profits net income for 1942, the surviving corporation deducted the

merged corporation's unused excess profits credits for 1940 and 1941.

The Commissioner disallowed the deduction and the Tax Court sustained the Commissioner.

The **Stanton Brewery** case involved both section 710 (c) (3) (B), I. R. C. 1939, which is exactly parallel in terms to section 122 (b) (2) (C) here involved, and a related statute, section 742, which bears no analogy to the instant case. In tracing the background of the present litigation it should be noted that the bulk of the Tax Court's opinion in the **Stanton** case, and the only part in which it makes an independent analysis of the issues, is devoted to consideration of the arguments involving section 742. 11 T. C. 311-313. When it came to consider the argument under section 710, whether or not the surviving corporation was "the taxpayer" entitled to the carry-over under that statute, the Court held that it was not, merely citing **New Colonial Ice Co. v. Helvering**, 292 U. S. 435 (1934), which did not, however, involve a statutory merger. 11 T. C. 314.

In reversing the Tax Court, the Court of Appeals in its majority opinion, notwithstanding **New Colonial Ice**, upheld the appellant's position that the merger survivor was the "taxpayer" under section 710, and said little of the arguments involving section 742. A dissent by Judge Learned Hand, conversely, rested largely on the second statute, finding it unnecessary to discuss the "taxpayer" argument. 176 F. (2d) 578.

In this situation, the Government's subsequent policy of litigating cases of statutory merger where excess profits tax credits were in issue [e. g., **California Casket Co.**, 19 T. C. 32 (1952); **E. & J. Gallo Winery**, 12 T. C. M. 414 (1953), and **Koppers Co., Inc. v. U. S.**, supra (1955)] is not wholly inexplicable since such cases conceivably might have turned upon section 742, notwithstanding the ma-

jority in **Stanton Brewery** and entirely apart from **New Colonial Ice**. But it is not as easy to understand the Government's persistence in the present case and in other net operating loss cases [**Moldit, Inc. v. Jarecki**, 53-2 U. S. T. C., par. 9551 (D. C. Ill. N. D.), appeal dismissed pursuant to stipulation (7th Cir., July 26, 1954); **Newmarket Manufacturing Co. v. U. S.**, 130 F. Supp. 706 (D. C. Mass., 1955), rev'd, 233 F. (2d) 493 (1st Cir., 1956)], which in principle parallel **Stanton Brewery** as closely as section 122 parallels section 710 in the 1939 code.[9] The Government's avowed theory has been that these cases are controlled by **New Colonial Ice**. See, for example, Brief for Respondent in Opposition herein, page 5. But as noted above **New Colonial Ice** did not involve statutory merger, and, as developed below, is clearly distinguishable on this ground. If it were not, there would be a conflict between that case and **Stanton Brewery**, yet the Government did not request certiorari in **Stanton Brewery**.

The truth is that the Government until very recently understood and agreed that in cases of statutory merger (and in at least one particular more generally[10]) questions of succession of tax attributes of the predecessor corporations are not governed by **New Colonial Ice**.

Thus, in 1950, the Commissioner ruled that contributions by a predecessor company to fund past service credits under a pension plan were deductible by the suc-

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[9] It is possible that the Government finds a basis for distinguishing *Moldit* and *Newmarket* from *Stanton Brewery* in that the former involved carry-backs as opposed to carry-overs. See Brief for Resp. in Opposition herein, p. 9, note 2. The Tax Court has made such a distinction. *Standard Paving Co. v. Commissioner*, 13 T. C. 425, 447 (1949).

[10] See Mim. 5957, 1945 Cum. Bull. 181, 187, holding that certificates of necessity and attendant accelerated amortization generally pass to the transferee in a non-taxable reorganization under section 112 (b) of the 1939 Code.

cessor company which took over all the assets and liabilities of the predecessor pursuant to a statutory merger. The ruling states:

> ". . . the problem involved is one to be resolved in accordance with the line of distinction to be drawn between **New Colonial Ice Company, Inc., v. Helvering** . . . and **Helvering v. Metropolitan Edison Company** . . . . In **New Colonial Ice Company, Inc., v. Helvering**, supra, a new corporation was denied a deduction in respect of net operating losses previously sustained by another corporation the assets of which had been acquired, subject to liabilities, for stock of the successor, the old corporation being subsequently dissolved. In **Helvering v. Metropolitan Edison Company**, following mergers consummated pursuant to state law and in connection with which a parent corporation acquired the assets, subject to liabilities, of its subsidiaries the parent was allowed to deduct unamortized discount and expense on bonds issued by the subsidiaries prior to the mergers.
>
> "Accordingly, since the N Company acquired the assets of the M Company pursuant to a statutory merger which **by operation of law effected a fusion of the assets and liabilities** of the respective companies it is entitled to deductions in succeeding years, commencing with 1950, with respect to the balance of $350,000, **to the same extent as the M Company would have been entitled had it continued in business.**" P. S. 62, C. C. H., Standard Fed. Tax. Rep. 1950, Vol. 5, par. 6118. (Emphasis supplied.)[11]

Again, in 1951, the Government in opposing certiorari in a loss carry-back case said that:

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[11] The decisions in the *New Colonial Ice* and *Metropolitan Edison* cases are discussed infra, pp. 30-32.

28-33

> "The assertion of conflict with **Stanton Brewery** . . . is not well founded. That decision was based squarely on the premise that the resulting corporation in a merger is the same taxpayer as the component corporation. Here there was no merger . . ." Brief for the Respondent in Opposition, p. 15, **Standard Paving Co. v. Commissioner,** 342 U. S. 860 (1951).

This is of course consistent with the Government's failure to assert conflict between **Stanton Brewery** and **New Colonial Ice.**

In keeping with the same position, in 1952, the Commissioner appears to have conceded the very issue here involved, that a surviving corporation is entitled under the 1939 Code to a net operating loss carry-over for a loss sustained by a merged corporation. **Morrisdale Coal Mining Co.,** 19 T. C. 208, 210 (1952).

What, then, is the explanation for the origin of the present controversy, since this is a case of statutory merger; and as such by the Government's own admission governed by **Metropolitan Edison** rather than by **New Colonial Ice?** Petitioner suggests that the answer is to be found in the Government's brief in **Koppers Company, Inc. v. United States,** supra, which describes an earlier "established policy" expressed in "unpublished rulings" that

> "except in instances where the merger or consolidation is brought about for the purpose of tax avoidance the corporation surviving a statutory merger or consolidation will be permitted to carry over a net operating loss of a component in that merger **to the extent that the absorbed corporation would have been able to carry over that loss had it continued its separate existence** . . ." Brief for the United States, pp. 20-21.

The brief at p. 21 goes on to indicate that this policy was not abandoned until after the commencement of the present controversy.

At no stage of this case has the Government questioned the motivation for the merger, but it has emphasized the fact that the locations formerly occupied by the Evanston, Lawrence and Hampton corporations were operated unprofitably in the year after the merger, together with the fact that the losses of several businesses are involved, as a basis for denying conflict between the decision here and those in **Stanton Brewery** and **Gallo Winery**. Brief for Resp. in Opposition, pp. 6-9.

Therefore, it appears that unless the Government's position has changed in the course of litigation, the only real dispute between the Government and the petitioner is whether these special facts justify departure from the rule of the cited cases, and certiorari having been granted by this Court, the sole basis for the Government's position has already been removed.

Even if the granting of the writ herein were not to be given this effect, the Government's contention that this case is distinguishable from **Stanton Brewery** has become untenable by virtue of the Government's recent application for certiorari in **United States v. Newmarket Mfg. Co.**, No. 216, filed June 28, 1956. If there be conflict between the present case and **Newmarket**, which like **Stanton Brewery** involves the merger of a single operating company and its parent, then the grounds on which the Government would distinguish the present case and **Stanton Brewery** are obviously unsound. The Government evidently is aware of its dilemma, for in asking for certiorari in the **Newmarket** case, it alleges not conflict but similarity between that case and this one, and makes the curious request that disposition of its petition be held in abeyance until the Court's decision herein. Petition, p. 5.

B. The Recent Cases.

The Court of Claims and two Courts of Appeals in a series of recent cases above cited have followed **Stanton Brewery** in upholding the right of surviving corporations in statutory mergers to net operating loss or excess profits credit carry-overs and carry-backs. **Koppers Company, Inc. v. U. S.**, 134 F. Supp. 290 (Ct. of Claims, Oct. 4, 1955); **E. & J. Gallo Winery v. Commissioner**, 227 F. (2d) 699 (9th Cir., Nov. 11, 1955), reversing the Tax Court, 12 T. C. M. 414 (1953); **Newmarket Manufacturing Co. v. U. S.**, 233 F. (2d) 493 (1st Cir., May 18, 1956), reversing 130 F. Supp. 706 (D. C. Mass., 1955).

In the **Koppers Company** case, a parent Massachusetts trust, a subsidiary Massachusetts trust and two subsidiary Delaware corporations were merged under the laws of Massachusetts and Delaware into Koppers Company, Inc., a newly-organized Delaware corporation. The Court of Claims held that the surviving corporation was entitled under section 710 (c) (3) (A), I. R. C. 1939 (considered both independently and in conjunction with sections 740 and 742), to carry back and apply its unused excess profits credit for a period ended after the merger in determining consolidated excess profits tax net income of the several corporations for a period ended prior to the merger.

In the **Gallo Winery** case, it appeared that Valley Agricultural Company was incorporated in 1926 and Gallo Winery in 1942, both in California. Gallo engaged in the railroad tank car business for one year. In 1943-44 members of the Gallo family acquired a controlling interest in Valley. In 1944 Gallo amended its charter to authorize it to engage in the winery business, and acquired such a business from the Gallo family. 12 T. C. M. 414, 415.

In 1945 the two corporations merged under California statute. The Court of Appeals held that Gallo Winery,

the surviving corporation, was entitled under section 710 (c) (3) (B), I. R. C. 1939, to carry over and apply an unused excess profits credit of Valley for a period ended before the merger in determining its excess profits tax net income for a period ended after the merger.

In the **Newmarket** case, a Massachusetts corporation organized and merged into a Delaware subsidiary under the applicable statutes of Massachusetts and Delaware. The Court of Appeals held that the surviving corporation was entitled under section 122 (b) (1) (B), I. R. C. 1939, to carry back and apply its net operating loss for a period ended after the merger in determining taxable net income of the merged corporation for a period ended prior to the merger.

Petitioner considers each of these three cases, together with **Stanton Brewery, Inc. v. Com.**, supra, to be authority for its position. While all of them except **Newmarket** involve unused excess profits tax credits rather than net operating losses, it is not disputed that the applicable tax statutes, section 710 and section 122 of the 1939 Code, respectively, are substantially identical, and while the **Koppers Company** and **Newmarket** cases involve carry-backs rather than carry-overs, this merely makes them *a fortiori* authority for petitioner, because if the tax experience of the surviving corporation (the whole) may be attributed to each of the merged corporations (the parts) the converse is at least as clear.

In short, the history of the present problem before the Treasury and in the courts shows the Government's stated position in this litigation in one respect to be totally inconsistent with its very recently past position, and in the other respect to be untenable; and reveals a singular preponderance of authority in support of petitioner's position that in cases of statutory merger, pre-merger tax credits

such as those covered by section 122 of the 1939 Code emerge in favor of the surviving corporation. Three Courts of Appeal and the Court of Claims have so held; the decision from which this petition was taken stands alone on the other side. By way of explanation, it may be noted that of the three recent cases above cited, all were decided after the decision of the District Court in the present case, entered April 15, 1955; that the **Newmarket** case was decided after the decision of the Court of Appeals herein, entered January 19, 1956; that the **Koppers Company** and **Gallo Winery** cases were not decided in time for petitioner to argue them in its brief filed August 30, 1955, in the Court of Appeals, and that the latter decision came too late for it to be included in oral argument presented November 17, 1955, although the **Koppers Company** case was mentioned in oral argument and **Gallo Winery** was called to the Court's attention prior to its decision. The petition for rehearing herein was prompted by the fact that the Court of Appeals' opinion makes no mention of the **Koppers Company** case and shrugs off **Gallo Winery** as all one with **Stanton Brewery** (R. 47, 57).

III. THE COURT OF APPEALS' OPINION.

The Court of Appeals at the outset seeks to place petitioner under an argumental handicap, citing the proposition that tax deductions being a matter of "legislative grace," the taxpayer has the burden of sustaining them (R. 50). If this means only that the taxpayer has the burden of appellate persuasion akin to the burden of trial proof, petitioner accepts it, having demonstrated that it is entitled to the carry-over under a reasonable construction of the statute. But if the "legislative grace" rule means strict construction against the taxpayer and in favor of the Government, it must be rejected as an easy generaliza-

tion which permits a court to abdicate its duty and function.[12]

As this Court has said:

> ". . . where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld. . . ." **Lewyt Corp. v. Commissioner,** 349 U. S. 237, 240 (1955).

The Court of Appeals in its opinion next relies on **New Colonial Ice Co. v. Helvering,** supra. After briefly noting the "factual difference" between that case and the present one (R. 56), the Court goes on to apply the holding and the language there to the facts here with complete disregard for vital differences.

In the **New Colonial Ice** case, a corporation engaged in the ice business was in financial difficulty. A new corporation was organized, the assets of the old corporation were transferred to the new in exchange for stock, which was distributed to stockholders of the old corporation in exchange for their stock. The corporate existence of the old corporation continued for almost two years after the transfer. The question was whether the new corporation was entitled to carry over net losses of the old corporation under Section 204 (b) of the Revenue Act of 1921, which provided:

> "If . . . any taxpayer has sustained a net loss, the amount thereof shall be deducted from the net income of the taxpayer for the succeeding taxable year; . . ."

292 U. S. 437.

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[12] See E. N. Griswold, *An Argument Against the Doctrine That Deductions Should Be Narrowly Construed as a Matter of Legislative Grace,* 56 Harv. L. Rev. 1142 (1943).

The Court first considered the petitioner's position as requiring that the statute be construed to allow the carry-over to a taxpayer **other than** the one sustaining the loss. Here it invoked the "legislative grace" rule. l. c. 440. The Court then turned to the "alternative contention that, even though the section be not as broad as claimed, the deduction should be allowed, because 'for all practical purposes the new corporation was the same entity as the old one, and therefore the same taxpayer.'" l. c. 441.

The Court rejected this contention, but more important here are the Court's reasons for doing so:

> 1. This contention "is not in accord with the view in which the stockholders and creditors proceeded when the new company was brought into being. They deserted the old company and turned to the new one because they regarded it as a distinct corporate entity and therefore free from difficulties attending the old one." l. c. 441.

Contrast the present case where the petitioner as the surviving corporation in a statutory merger automatically succeeded to all the liabilities and obligations, i. e., the "difficulties," of each of the merging corporations.

> 2. ". . . we are of the opinion that in fact and in law the two corporations were not identical, but distinct. This was plainly implied in the transfer of assets and business from one to the other. That transaction was voluntary and contractual, not by operation of law." l. c. 441.

Contrast the present case where the transfer of assets and business to the petitioner as the surviving corporation in a statutory merger was unquestionably not voluntary and contractual, but by operation of law. **Helvering v. Metropolitan Edison Co.**, 306 U. S. 522, 528 (1939); **U. S. v. Seattle-First National Bank**, 321 U. S. 583, 587-588 (1944).

The petitioner in **New Colonial Ice**, in making the "same taxpayer" argument, was reduced to reliance upon continuity of business and continuity of stock ownership. l. c. 439. The Court of Appeals here cited the Supreme Court's answer, that continuity of business was not enough, l. c. 439, and that continuity of stock ownership was immaterial, l. c. 439, 442 (R. 54-55). But the Court of Appeals went astray in interpreting and applying this Court's requisites for allowance of the carry-over, "not continuity of business alone but of ownership and tax liability as well." l. c. 439.

In holding that such "continuity of business" is absent in the present case (R. 57), and again in attempting to distinguish **Stanton Brewery** as involving a "continuing enterprise" (R. 53-54), the Court of Appeals interprets these phrases not as requiring uninterrupted operation of the same business or businesses, despite a change in the form of operation (which is the way we read them), but as limiting the carry-over to a case of reorganization of a single business. It is submitted that this is to require not "continuity," but "unity" of business. There is continuity of business here; in the same sense as in the other cases.

Moreover, unlike those in **New Colonial Ice**, the facts in this case satisfy the other two conditions as well—continuity of ownership and tax liability. The Court of Appeals' only reason for denying that there is continuity of ownership, just as with continuity of business, is the presence of seventeen separate businesses (R. 56-57), whereas the matter of continuity of tax liability is ignored entirely. But again, what this Court deemed essential to continuity of ownership and of tax liability bears no relation to the number of businesses; rather, it consists in the **method of transfer** of the business:

> " . . . the matter of importance here, **as will be shown presently**, is not continuity of business alone

but of ownership and tax liability as well. Had the transfer from one company to the other been effected by an unconditional sale for cash, there would have been continuity of business, but not of ownership or tax liability." l. c. 439. (Emphasis supplied.)

The Supreme Court went on to "show" the necessity for continuity of ownership and tax liability by construing the applicable statute to limit the deduction to the taxpayer sustaining the loss. l. c. 440-441. Then, as noted, it rejected the petitioner's "same taxpayer" argument because the "transaction was voluntary and contractual, not by operation of law." l. c. 441.

The transaction in this case having been by operation of law, it follows that there was continuity of both ownership and tax liability within the meaning of the **New Colonial Ice** opinion.

The Court of Appeals, on the other hand, rejects the authority of **Helvering v. Metropolitan Edison Company**, 306 U. S. 522 (1939). That case involved two corporate reorganizations. The first consisted of a transfer of all the assets of certain subsidiaries to their parent company made in accordance with a Pennsylvania statute. The second consisted of a sale of all the assets of another subsidiary to the same parent, not made in accordance with the statute. In the first, the parent, after reorganization, redeemed bonds which the subsidiaries had issued prior to reorganization. In the second instance, the parent after reorganization redeemed bonds which the subsidiary had issued and the parent had guaranteed prior to reorganization. In both instances, the question was whether the parent could deduct bond discount and expense incident to issuance of the bonds which remained unamortized at the time of redemption.

The Supreme Court noted that:

"The petitioner concedes that if there has been a true merger or consolidation whereby the identity of the corporation issuing the bonds continues in the successor and the latter becomes liable for the debts of the former by operation of law, the successor may deduct amortization of discount and expense in respect of bonds issued by its predecessor as well as unamortized discount and expense on any of such bonds retired prior to maturity. The rule is not applicable upon a mere sale by one corporation of all its assets to another which assumes the liabilities of the former." 306 U. S. 526-527.

The Court said that whether the transfers of assets constituted mergers was a question of Pennsylvania law and that under that law the second transaction was a "de facto merger," while the first "has all the elements of a merger and comes within the principle that the corporate personality of the transferor is drowned in that of the transferee." l. c. 529; and held that the bond discount and expense were deductible in both situations.

It will be noted that the holding applies to the case where the bonds were not guaranteed by the parent as well as to the other. Cf. Opinion of Court of Appeals (R. 58).

The Court of Appeals would distinguish **Metropolitan Edison** on the ground that the item deducted was a post-merger credit of a successor corporation, as opposed to a pre-merger credit of a predecessor (R. 58). This distinction, as applied to a case of statutory merger, was considered but rejected in **Stanton Brewery, Inc., v. Com.**, supra, p. 576, and in **E. & J. Gallo Winery Com.**, supra, p. 705. This Court itself in the **New Colonial Ice** opinion indicated that both types of deduction turn upon the same principle when it cited together **Athol Mfg. Co. v. Commissioner**, 54 F. (2d) 230 (1st Cir., 1931), and **Turner-Farber-Love Co. v. Helvering**, 68 F. (2d) 416 (D. C. Cir., 1933),

the former denying loss carry over and the latter amortization of bond discount. 292 U. S. 442.

After interpreting **New Colonial Ice** to preclude the carry-over where the profits and losses of several businesses are involved, and attempting to distinguish **Stanton Brewery** on this ground, the Court of Appeals concludes that to allow the deduction in such a case would be to apply section 122 in a manner never intended by Congress (R. 60).

It is difficult to square this view of the law with such cases as **Northway Securities Company**, 23 B. T. A. 532 (1931), and **Alprosa Watch Corporation**, 11 T. C. 240 (1948), both involving separate businesses operated by the same corporation, which in each case was permitted to offset earlier-year losses of one business against later-year profits of the other. The fact that the separate businesses may have been operated by different corporations does not necessarily vary the result. There can be no question that where a corporation whose business has been profitable merges into a corporation with losses, the surviving corporation, under section 122, may carry over the losses and offset them against later profits attributable to the business formerly operated by the other corporation, since in such a case the corporation claiming the deduction under any construction of the statute would be the "taxpayer" having sustained the losses. Further evidence that the crediting of one corporation's losses against another's profits is contemplated by the 1939 Code is afforded by section 129, which provides that if any corporation acquires property of another corporation in a tax-free reorganization **for the principal purpose of evading or avoiding tax** by obtaining a deduction, **then** the deduction shall not be allowed. I. R. C. 1939 as amended, 26 U. S. C. A. (1955), sec. 129.[13]

[13] See H. R. Rep. No. 871, 78th Cong., 1st Sess. 24, 49 (1943); S. Rep. No. 627, 78th Cong., 1st Sess. 26, 58 (1943).

Therefore, the Court of Appeals' objection that the losses of one corporate business cannot be offset against the profits of another corporate business does not withstand examination.

In this connection, while the record in this case is devoid of any reference to section 129 or any other suggestion of improper tax avoidance, there are indications that the Courts below had a vague notion that there is something immoral about petitioner's position. The Court of Appeals quotes the trial court as follows:

> "'The effect of a ruling such as plaintiff seeks would be establishing a precedent susceptible of widespread abuse . . . bankrupt corporations with tax credits would find themselves the object of desirable purchase or 'merger' by or with corporations with tax liabilities, in order that after purchase the tax credits could be used to offset taxes due, just as plaintiff would do in this case. Regardless of what the motive or motives for including the corporations with tax credits in the merger, we have no doubt that use of their tax credits was one . . . .'" (R. 51).

It is submitted that in the final analysis both the District Court and the Court of Appeals may well have reached their decisions on the basis of this unfounded suspicion of tax avoidance, coupled with the effect they gave to the fact that the locations operated by the three merged corporations having losses before the merger continued to be unprofitable in the year after the merger. The Court of Appeals believed that to allow the carry-over in this situation "would mean that the merger of these corporations and the merger alone would be responsible" for the petitioner's obtaining the deduction (R. 57).

If the Court is giving credence to the trial court's suggestion that the plan of merger was adopted so that tax

credits would not be lost (cf. R. 51), it is crediting petitioner with a foresight that it must disclaim. It is, indeed, stipulated that the stores operated by the corporations which had loss carry-overs at July 31, 1949, continued to lose money in the taxable year ended July 31, 1950 (R. 17). As the merger was effected August 1, 1949, and obviously planned some time before that date, however, this fact hardly could have influenced the decision to merge.

Secondly, it is not necessarily true that, had the merger not taken place, the credits could not have been utilized by the merged corporations, as the statutory carry-over period is three years, and on the facts, the losses would have been available for carry-over by the loss corporations for from one to two years after the year ended July 31, 1950 (R. 17).

Finally, and most important, as the Court of Appeals itself recognized, this is not a "logical argument" against petitioner's position (R. 57). It is not disputed that at July 31, 1949, the Evanston, Lawrence and Hampton corporations had sustained net operating losses for years covered by the statute. This condition being satisfied, the only question under the statute is whether the petitioner is entitled to carry over these losses. Petitioner had income against which to offset the losses in the year in question. The fact that losses were attributable to particular segments of petitioner's operating assets after the merger is wholly immaterial.

CONCLUSION.

Therefore, petitioner asks that this Honorable Court reverse the judgment of the United States Court of Appeals in its Docket No. 15,397 and remand the case with instructions for further disposition consistent with such reversal (including the ultimate award to the petitioner of judgment against respondent in the amount demanded by peti-

tioner in Docket No. 6722 of the United States District Court for the Eastern District of Missouri).

Respectfully submitted,

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APPENDIX.

Statutes Involved.

Internal Revenue Code of 1939:

Sec. 23. **Deductions from Gross Income.**

In computing net income there shall be allowed as deductions:

* * * * * * *

(s) [as added by Section 211, Revenue Act of 1939, c. 247, 53 Stat. 862] **Net Operating Loss Deduction.**—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * * * *

(26 U. S. C., 1952 ed., sec. 23.)

Sec. 122 [as added by Section 211, Revenue Act of 1939, supra]. **Net Operating Loss Deduction.**

(a) [as amended by Section 105, Revenue Act of 1942, c. 619, 56 Stat. 798] **Definition of Net Operating Loss.**—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [as amended by Section 215, Revenue Act of 1950, c. 994, 64 Stat. 906] **Amount of Carry-Back and Carry-Over.**—

(1) **Net operating loss carry-back.**—

(A) **Loss for Taxable Year Beginning Before 1950.**—If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net oper-

ating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year * * *.

* * * * * * *

(2) **Net operating loss carry-over.**—

* * * * * * * *

(C) [as added by Section 330, Revenue Act of 1951, c. 521, 65 Stat. 452] **Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950.**—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years * * *.

* * * * * * *

(c) [As amended by Sections 105 (e) (3) (B) and 153 (b) of the Revenue Act of 1942, supra, and Section 121 (g) (2) of the Revenue Act of 1950, supra] **Amount of Net Operating Loss Deduction.**—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income [computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)] exceeds, in the case of a taxpayer other than a corporation, the net income

(computed without such deduction), or, in the case of a corporation, the normal-tax net income [computed without such deduction and without the credits provided in sections 26 (b) and (i)];

* * * * * * * *

(26 U. S. C., 1952 ed., sec. 122.)

(ii) **Historical Note.**

The concept of loss carry-back and carry-over was introduced to the federal income tax by the Revenue Act of 1918, which provided for a one-year carry-back and a one-year carry-over of "net loss." Section 204 (b), Act of Feb. 24, 1919, c. 18, 40 Stat. 1057. The provision was later changed by eliminating the carry-back and by increasing the carry-over period to two years, and as such it appeared in all revenue acts prior to the Act of 1932, which reduced the carry-over period to one year. The net loss carry-over was entirely eliminated in the National Industrial Recovery Act of 1933. See H. R. Rep. No. 855, 76th Cong., 1st Sess. 9-10. A two-year carry-over (of "net operating loss") was restored by the Revenue Act of 1939, which added Sections 23 (s) and 122 to the Internal Revenue Code. Section 211, Act of June 29, 1939, c. 247, 53 Stat. 862-885.

In 1942, section 122 (b) became 122 (b) (1) and 122 (b) (2), the former making provision for a two-year carry-back and the latter continuing provision for a two-year carry-over. Section 153 (a), Act of Oct. 21, 1942, c. 619, 56 Stat. 798. The statute was further refined in 1950, when, with respect to losses thereafter sustained, the carry-back period was increased to five years. Thus both 122 (b) (1) and 122 (b) (2) were subdivided into subparagraphs (A) and (B). Section 215 (a), Act of Sept. 23, 1950, c. 994, 64 Stat. 906. In 1951 the carry-over provisions were amended to provide for a three-year carry-over of losses sustained

between 1947 and 1950. Section 330 (b), Act of Oct. 20, 1951, c. 521, 65 Stat. 452, adding 122 (b) (2) (C).

(iii) **State Statutes Governing Merger.**

Sections 62 (Part), 68 and 70, The General and Business Corporation Act of Missouri, Laws 1943, p. 410, secs. 62, 68, 70, R. S. Mo. 1949, sec. 351.410, 440 and 450.

Section 62 (Part):

"Any two or more domestic corporations formed for a purpose for which a corporation may be formed under this Act and any domestic corporation or corporations and foreign corporation or corporations formed for a purpose of which a corporation might be formed under this Act may merge into one of such corporations. . . ."

Section 68:

"Upon the issuance of the certificate of merger or the certificate of consolidation by the Secretary of State, the merger or consolidation shall be effected."

Section 70:

"When such merger or consolidation has been effected:

(a) The several corporations parties to the plan of merger or consolidation shall be a single corporation, which, in the case of a merger, shall be that corporation designated in the plan of merger as the surviving corporation, and, in the case of a consolidation, shall be the new corporation provided for in the plan of consolidation.

(b) The separate existence of all corporations parties to the plan of merger or consolidation, except the surviving or new corporation, shall cease.

(c) Such surviving or new corporation shall have all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under this Act.

(d) Such surviving or new corporation shall thereupon and thereafter possess all the rights, privileges, immunities and franchises, as well of a public as of a private nature, of each of the merging or consolidating corporations; and all property, real, personal and mixed, and all debts due on whatever account, including subscriptions to shares, and all other choses in action, and all and every other interest, of or belonging to or due to each of the corporations so merged or consolidated, shall be taken and deemed to be transferred to and vested in such single corporation without further act or deed; and the title to any real estate, or any interest therein, under the laws of this State vested in any of such corporations shall not revert or be in any way impaired by reason of such merger or consolidation.

(e) Such surviving or new corporation shall thenceforth be responsible and liable for all the liabilities and obligations of each of the corporations so merged or consolidated, and any claim existing or action or proceeding pending by or against any of such corporations may be prosecuted to judgment as if such merger or consolidation had not taken place, or such surviving or new corporation may be substituted in its place. Neither the rights of creditors nor any liens upon the property of any of such corporations shall be impaired by such merger or consolidation.

(f) In the case of a merger, the articles of incorporation of the surviving corporation shall be deemed to be amended to the extent, if any, that changes in its articles are stated in the articles of merger; and, in the case of a consolidation, the statements set forth in the

articles of consolidation and which are required or permitted to be set forth in the articles of incorporation of corporations organized under this Act shall be deemed to be the articles of incorporation of the new corporation.

(g) The aggregate amount of the net assets of the merging or consolidating corporations which was available for the payment of dividends immediately prior to such merger or consolidation, to the extent that the value thereof is not transferred to stated capital by the issuance of shares or otherwise, shall continue to be available for the payment of dividends by such surviving or new corporation."

Sections 61 (Part), 67, 69 and 69a (Part), The Business Corporation Act (Illinois), Ill. R. S., c. 32, sec. 157.

Section 61 (Part):

"Any two or more corporations may merge into one of such corporations. . . ."

Section 67:

"Upon the issuance of the certificate of merger or the certificate of consolidation by the Secretary of State, the merger or consolidation shall be effected."

Section 69:

"When such merger or consolidation has been effected:

(a) The several corporations parties to the plan of merger or consolidation shall be a single corporation, which, in the case of a merger, shall be that corporation designated in the plan of merger as the surviving corporation, and, in the case of a consolidation, shall be the new corporation provided for in the plan of consolidation.

(b) The separate existence of all corporations parties to the plan of merger or consolidation, except the surviving or new corporation, shall cease.

(c) Such surviving or new corporation shall have all the rights, privileges, immunities, and powers and shall be subject to all the duties and liabilities of a corporation organized under this Act.

(d) Such surviving or new corporation shall thereupon and thereafter possess all the rights, privileges, immunities, and franchises, as well of a public as of a private nature, of each of the merging or consolidating corporations; and all property, real, personal, and mixed, and all debts due on whatever account, including subscriptions to shares, and all other choses in action, and all and every other interest, of or belonging to or due to each of the corporations so merged or consolidated, shall be taken and deemed to be transferred to and vested in such single corporation without further act or deed; and the title to any real estate, or any interest therein, vested in any of such corporations shall not revert or be in any way impaired by reason of such merger or consolidation.

(e) Such surviving or new corporation shall thenceforth be responsible and liable for all the liabilities and obligations of each of the corporations so merged or consolidated; and any claim existing or action or proceeding pending by or against any of such corporations may be prosecuted to judgment as if such merger or consolidation had not taken place, or such surviving or new corporation may be substituted in its place. Neither the rights of creditors nor any liens upon the property of any such corporations shall be impaired by such merger or consolidation.

(f) In the case of a merger, the articles of incorporation of the surviving corporation shall be deemed

to be amended to the extent, if any, that changes in its articles are stated in the articles of merger; and, in the case of a consolidation, the statements set forth in the articles of consolidation and which are required or permitted to be set forth in the articles of incorporation of corporations organized under this Act shall be deemed to be the articles of incorporation of the new corporation.

(g) The aggregate amount of the net assets of the merging or consolidating corporations which was available for the payment of dividends immediately prior to such merger or consolidation, to the extent that the value thereof is not transferred to stated capital by the issuance of shares or otherwise, shall continue to be available for the payment of dividends by such surviving or new corporations."

Section 69a (Part):

"One or more foreign corporations and one or more domestic corporations may be merged or consolidated . . . ."

"The effect of such merger or consolidation shall be the same as in the case of the merger or consolidation of domestic corporations, except, if the surviving or new corporation is to be governed by the laws of any state other than this State, to the extent that the laws of such other state shall otherwise provide."

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IN THE

SUPREME COURT OF THE UNITED STATES.

No. 64.

LIBSON SHOPS, INC.,
Petitioner,
vs.
GUSTAVE F. KOEHLER, District Director
of Internal Revenue.

On Writ of Certiorari to the United States Court of Appeals
for the Eighth Circuit.

REPLY BRIEF FOR THE PETITIONER.

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INDEX.

	Page
Reply to respondent's statement	1
Reply to respondent's argument	2
1. The argument under the statute	2
2. The "not-the-same-taxpayer" argument	4
3. The "not-the-same-business" argument	7
Conclusion	9

Cases Cited.

Dodier Realty and Investment Co. v. St. Louis National Baseball Club, 238 S. W. (2d) 321 (Mo., 1951)	5
Helvering v. Metropolitan Edison Co., 306 U. S. 522, 528 (1939)	5
LeTulle v. Scofield, 308 U. S. 415 (1940)	9
New Colonial Ice Co. v. Helvering, 292 U. S. 435	2, 5
Olympic Radio & Television, 349 U. S. 232	4
Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U. S. 462 (1933)	9
Stanton Brewery v. Comm., 176 F. (2d) 573	6, 7
U. S. v. Seattle-First National Bank, 321 U. S. 583, 587-588 (1944)	5

Statutes Cited.

Internal Revenue Code:	
Section 23 (s), 1939	2
Section 112 (b), 1939	7
Section 112 (g)	7

Section 122 (b) (2) (C) 2
Section 122, 1939 ..... 2, 6
Section 204 (b), 1921 2
Section 311 7
Section 354, 361, 368 (1954) 7
Section 368 (a) (1) (A) 7
Section 381 (1954) 7
Section 382 (a) (1) (C) (1954) 8
Section 3797 (a) (14) (1), (3) 6

Miscellaneous.

1939 Committee Report, H. Rep. No. 855, 9-10 3

IN THE

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REPLY BRIEF FOR THE PETITIONER.

Reply to Respondent's Statement.

Respondent's assertion (Br. 3) that on August 1, 1949, the sixteen corporations were "dissolved" is not supported by the Record and is contrary to the fact. The corporations were merged but not dissolved (R. 15).

The assertion (Br. 3) that in the year ended July 31, 1950, each of the "businesses" formerly operated by the three corporations with losses continued to sustain a loss is not accurate. The fact is that the **locations** formerly operated by the three corporations as separate businesses continued to sustain losses when operated by petitioner as parts of a unified business (Cf. Pet. Br. 24, 34; R. 17).

Reply to Respondent's Argument.

1. **The Argument Under the Statute.**

The Government argues, first, that under Sections 23 (s) and 122 of the 1939 Code the deduction in question is available only to the taxpayer who sustained the loss (Br. 9-19). In support of this argument the Government cites the language of Section 122 (b) (2) (C), reasoning as follows:

(i) The statute permits a loss carry-over "'if . . . the taxpayer' sustained the loss.'"

(ii) "Thus the only 'taxpayer' authorized to carry over a loss . . . is 'the' taxpayer who had the loss" (Br. 11).

In view of the words omitted from the quotation in (i) above, the Government's reasoning is an obvious non sequitur. The statute says: **"If for any taxable year beginning after December 31, 1947, and before January 1, 1950,** the taxpayer has a net operating loss. . . ." (Emphasis supplied.) Thus "the" taxpayer referred to is not the taxpayer claiming a carry-over, but the taxpayer with respect to any given taxable year beginning between the prescribed dates, and all the statute goes on to say is that if such taxpayer has a loss, such loss **shall be** a carry-over for each of the three succeeding taxable years. It does not say for **whose** succeeding taxable years the loss shall be a carry-over.

The Government contends, moreover, that its conclusion from the language of Section 122 is confirmed by **New Colonial Ice Co. v. Helvering,** 292 U. S. 435, quoting from pages 440-441 (Br. 12). But, as the quoted portions of the opinion themselves reveal, Section 204 (b) of the 1921 Act there involved, unlike Section 122 here, explicitly identifies the taxpayer sustaining the loss as the taxpayer entitled to the deduction.

The Government, therefore, cannot find support for its first argument in the language of the statute.

The Government next points to the legislative history of the loss carry-over, in a further effort to show that the deduction is available only to the taxpayer who sustained the loss (Br. 13-16). In particular, it cites the 1939 Committee Report, H. Rep. No. 855, 9-10, as evidence of an intent limited to permitting a taxpayer with fluctuating business income to "average the income" over a period of years (Br. 15). But the quoted portion of the committee report merely notes that as "a" result of the 1932 repeal of the loss carry-over a business with alternating profit and loss suffered in comparison with a business with stable profits. This is not to say that this was the **only** result of the repeal, or consequently to imply that the only purpose of the re-enactment was to alleviate this condition. Obviously, the committee in this excerpt from its report is addressing itself to the simple case of carry-over uncomplicated by corporate reorganization.

Respondent would have us conclude from this that the carry-over was not intended to be allowed in any case of reorganization: "There was no intention . . . to permit the averaging of business income of different taxpayers" (Br. 15-16). Yet there can be no question that the statute by its very terms **does** permit the averaging of business income of different "taxpayers" (in the sense in which the Government understands that term) in the case, for example, where corporation A, with a history of profits, merges into corporation B, with a history of losses, and B subsequently offsets its earlier losses against profits derived from the assets acquired from A.

Congress must be assumed to have intended what it expressly permits. And Congress having intended to allow the deduction in the situation described, it is most unreasonable to attribute to Congress an intent to bar the carry-

over in the converse case, i. e., where, as here, the corporation having losses merges into the corporation having profits. Or, to adapt the language respondent quotes from the opinion of this Court in **Olympic Radio & Television**, 349 U. S. 232 (Br. 10-11), it may be that Congress granted **more** than some thought or more than was originally intended. "We can only take the Code as we find it and give it as great an internal symmetry and consistency as its words permit." 349 U. S. 236.

2. **The "Not-the-Same-Taxpayer" Argument.**

The Government's second argument is that petitioner is not the same taxpayer as the three corporations with losses (Br. 19-28).

In support of this argument, the Government first invokes the doctrine of corporate entity. It is submitted that this is inapposite.

Petitioner's position (so far as relevant to the "same taxpayer" argument) is that as a result of the merger, the **separate** existence of each of the corporations thereupon ceased. Petitioner at all times thereafter **included** each of the merged corporations. Discussion of the doctrine of corporate entity is appropriate only to distinguish the identities of the several corporations while they retained their separate existences, i. e., prior to the merger, and to identify the petitioner as an entity apart from its stockholders thereafter. The doctrine is of no help in explaining the relationship between petitioner and the other corporations **after** the merger. This relationship can only be understood in terms of the concept of statutory merger, which in a sense replaces the doctrine of corporate entity as a medium of understanding the inter-corporate relationship at the point where the latter ceases to function for this purpose.

When this is understood, the points made by the Government lose all force and meaning.

Thus the filing of separate returns for the last periods of separate existence of the corporations in no way conflicts with petitioner's contention with respect to their relationship after the merger. (Cf. Brief for Resp. p. 20.)

Thus the invocation of the corporate entity doctrine in the **New Colonial** cases is attributable to the continued **separate** corporate existences following the reorganization, and is not a precedent for application of the doctrine here. To contend that the cases are alike because the transfer here was "likewise voluntary and contractual" (Brief for Resp., p. 23, n. 7) is to fly in the face of the following decisions: **Dodier Realty and Investment Co. v. St. Louis National Baseball Club,** 238 S. W. (2d) 321 (Mo. 1951); **Helvering v. Metropolitan Edison Co.,** 306 U. S. 522, 528 (1939); **U. S. v. Seattle-First National Bank,** 321 U. S. 583, 587-588 (1944).

The Government's analysis, having at first ignored the import of the merger under state statutes, continues by affirmatively dismissing the latter on the grounds that the state law (1) does not erase the "separate prior existences" of the corporations, (2) does not purport to authorize a deduction, and (3) could not effectively authorize a deduction (Br. 25-26).

All this is fine but immaterial, as petitioner does not contend that the corporations were not separate **prior** to the merger, nor that the state statutes authorize the deduction. The contention is that in considering whether the deduction is authorized by the federal tax statute, effect must be given to state law insofar as it determines the federal statute's terms of reference. This is not new. It is precisely what this Court did in **Helvering v. Metropolitan Edison Co.,** supra.

As a matter of fact, the Government is in no argumentary position to deny that state law must be given this limited effect. If state law cannot be invoked to deter-

mine the question of continuity of corporate existence upon merger, it cannot with any more reason be invoked to determine the question of corporate existence prior to or after merger, i. e., "corporate entity." In the absence of any consideration of state corporation law, we are forced to resolve the question of terminology under Section 122 within the confines of the Internal Revenue Code. Thus "taxpayer" means "person" subject to tax; "person" includes "corporation"; and "corporation" includes "associations." I. R. C. 1939, Section 3797 (a) (14), (1) and (3). There was but one "association" before and after the merger, and the losses of that association can be offset against its profits.

Of course, the straightforward answer is that the Internal Revenue Code itself adopts state laws of incorporation in the definition of "corporation." That word "includes," but is not limited to, associations. It has always been recognized to mean and include any organization activated under state laws (whether or not an association). The notion that state law can establish existence, but not continuance, entity but not identity, is a shadow which vanishes with light.

The Government next addresses itself directly to the concept of statutory merger, arguing that for purposes of the "taxpayer" question, a merger is indistinguishable from other types of reorganization (Br. 28-41).

The argument is framed in terms of objections to the decision in **Stanton Brewery v. Comm.**, 176 F. (2d) 573. The first objection, that the decision violates the corporate entity doctrine, repeats argument made earlier and has been answered, supra, pp. 4-5.

The second objection amplifies argument made earlier, adding that to give effect to local law with respect to merger would prevent uniform application of the federal statute. But a statutory merger is a standardized con-

cept, recognized as such in the Internal Revenue Code. The tax law has long provided that no gain or loss is recognized upon certain exchanges in connection with certain corporate reorganizations. Section 112 (b), I. R. C. 1939. The term "reorganization" is defined in the 1939 Code to include "a statutory merger or consolidation," without any elaboration of meaning. Section 112 (g). Similar provisions are contained in the 1954 Code, Sections 354, 361 and 368. Evidently Congress is sufficiently confident in the uniform effects of statutory mergers in the several states to permit the question of tax-free reorganization to turn upon whether or not there has been such a merger, without necessity for further inquiry. Moreover, it will be noted that Congress has followed the same pattern in Section 381 of the 1954 Code, where it expressly authorizes carry-overs in corporate reorganizations, including "a statutory merger or consolidation" [Section 368 (a) (1) (A)], without so much as defining that term.

The Government's third objection to **Stanton Brewery** and to application of the merger concept confuses the primary liability of a merger successor for its predecessor's taxes, with the derivative liability of a transferee under 1939 Code, Section 311. That a merger successor is also liable under that section does not detract from the significance of the distinction. The difference in the nature of the liability is sufficiently indicated by the Government's own reference to the liability under Section 311 as being limited "to the extent of the value of the property received by the transferee" (Br. 31, n. 15). Of course the liability of a surviving corporation in a statutory merger is not limited in this or in any other way.

3. **The "Not-The-Same-Business" Argument.**

The Government's third argument is that even if petitioner is regarded as "the same taxable entity" as each of the merged corporations, it is not entitled to the deduc-

tion claimed "since its business was not the same" (Br. 41-47).

In support of this argument, the Government first repeats its earlier reference to the legislative history discussed and answered under 1, above.

The Government next cites Section 382 (a) (1) (C) of the 1954 Code, as precluding a carry-over "even by the same corporation unless, among other things, the corporation continues to carry on 'substantially the same' business as before." Whether careless or bold, this is a misleading statement of the law.

The only case in which a change in a "trade or business" carried on by a corporation is significant under Section 382 (a) is the case where such change is accompanied by a substantial change in stock ownership of the corporation having a loss carry-over, **and then only where the latter change is incident to a purchase.** It is only in this combination of circumstances that a carry-over is precluded by the statute cited by the Government. I. R. C. 1954, Sec. 382 (a).

On the other hand, in a case of change of stock ownership incident to a "reorganization" including a statutory merger) as opposed to a purchase, this change **alone and without reference to any change in trade or business** is made significant by Section 382 (b), which provides for partial reduction of loss carry-overs in such a case. It will be noted that there was no such change in stock ownership in the instant case (R. 16).

Thus, far from detracting from petitioner's position, consideration of Section 382 of the 1954 Code in fact enhances it. What Congress in effect says in Section 382 (b) is that the presence of "reorganization" **itself** supplies the only continuity in the business sense which is requisite

to an inter-corporate carry-over, and that in such cases the only variable in the equation is continuity of stock ownership. This approach is entirely logical, for it is a corollary of the proposition that continuity of interest is an essential ingredient of tax-free reorganization. **Pinellas Ice & Cold Storage Co. v. Commissioner,** 287 U. S. 462 (1933); **LeTulle v. Schofield,** 308 U. S. 415 (1940).

CONCLUSION.

The arguments made by the Government in its brief do not require any change in petitioner's original conclusion that the judgment of the Court below should be reversed.

Respectfully submitted,

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INDEX

	Page
Opinions below	1
Jurisdiction	2
Question presented	2
Statute and Regulations involved	2
Statement	2
Argument	4
Conclusion	11
Appendix	12

CITATIONS

CASES:

Gallo, E. & J., Winery v. *Commissioner*, 227 F. 2d 699 ..... 8, 9
Koppers Co. v. *United States*, 134 F. Supp. 290 9
New Colonial Co. v. *Helvering*, 292 U.S. 435 ..... 5, 6
Newmarket Manufacturing Co. v. *United States*, 130 F. Supp. 706 9
Stanton Brewery v. *Commissioner*, 176 F. 2d 573 ..... 7, 8, 9

STATUTES:

Excess Profits Tax Act of 1950 (Subchapter D of Chapter 1 of the Internal Revenue Code), 64 Stat. 1137 10

Internal Revenue Code of 1939:

Sec. 23(s) (26 U.S.C. 1952 ed., Sec. 23(s)) 4, 12
Sec. 122(a) (26 U.S.C. 1952 ed., Sec. 122(a)) 12
Sec. 122(b) (26 U.S.C. 1952 ed., Sec. 122(b)) 4, 5, 12
Sec. 122(c) (26 U.S.C. 1952 ed., Sec. 122(c)) 4, 13

Internal Revenue Code of 1954:

Sec. 381 (26 U.S.C. 1952 ed., Supp. II, Sec. 381) 10
Sec. 382 (26 U.S.C. 1952 ed., Supp. II, Sec. 382) 10

Revenue Act of 1945, c. 453, 59 Stat. 556, Sec. 422, repealing World War II Excess Profits Tax Act (Subchapter E of Chapter 2 of the Internal Revenue Code) 9

MISCELLANEOUS:

H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 41-42 (3 U.S.C. Cong. & Adm. News (1954), 4017, 4066-4067) 10
Treasury Regulations 111, Sec. 29.122-1 14

In the Supreme Court of the United States

October Term, 1955

No. 863

LIBSON SHOPS, INC., *Petitioner*

v.

GUSTAVE F. KOEHLER, District Director
Of Internal Revenue

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court (R. 36-46) is not officially reported. The opinion of the Court of Appeals (Pet. 13-29) is reported at 229 F. 2d 220.

JURISDICTION

The judgment of the Court of Appeals was entered January 19, 1956. (Pet. 13.) An order denying taxpayer's petition for rehearing was entered February 16, 1956. The petition for a writ of certiorari was filed April 14, 1956. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether the taxpayer corporation is entitled, under Sections 23(s) and 122 of the Internal Revenue Code of 1939, to carry over and deduct from its own income for the taxable year here involved net operating losses sustained in prior years by other corporations which were merged into it.

STATUTE AND REGULATIONS INVOLVED

Sections 23(s) and 122(a), (b), and (c) of the Internal Revenue Code of 1939, and Section 29.122-1(a) and (b) of Treasury Regulations 111, are set forth in the Appendix, *infra*, pp. 12-15.

STATEMENT

The material facts as stipulated (R. 14-35) and found by the District Court (R. 36) may be summarized as follows:

The taxpayer is a Missouri corporation organized at the beginning of 1946 under the name of Libson Shops Management Corporation. (R. 16, 21.) It engaged in the business of providing

management services for sixteen Missouri and Illinois corporations, each of which operated a store selling women's apparel at retail. (R. 16.) All of the outstanding stock of each of the corporations was owned, directly or indirectly, by the same eight individuals and in the same proportions. (R. 17, 24.)

On August 1, 1949, pursuant to the laws of Missouri and Illinois, the sixteen separate operating corporations were merged into the taxpayer corporation (R. 16-17, 21-35), and taxpayer's stock was issued in exchange for the stock of the merged corporations (R. 17-18). Under the terms of the merger, the name of the taxpayer corporation was changed, the amount and par value of its stock were revised, and its business purposes were extended. (R. 21-34.) After the merger, taxpayer operated the stores which had formerly been operated separately by the sixteen merged corporations. (R. 19.)

Prior to the merger, three of the merged corporations had sustained net operating losses from their respective businesses. In the year following the merger (the taxable year here involved), each of the businesses formerly operated by these three corporations continued to sustain a net operating loss. (R. 19.)

In its income tax return for the first taxable year after the merger (the year ended July 31, 1950), taxpayer claimed as a deduction the total

($22,432.76) of the net operating losses sustained before the merger by the three corporations. (R. 18-19.) With the deduction, taxpayer reported a net income of $46,794.70.

The Commissioner disallowed the claimed deduction, and taxpayer paid the resulting tax deficiency. (R. 15.) Taxpayer duly filed a claim for refund, which was disallowed, and then instituted the present action. (R. 20.) The District Court held that the claimed net operating loss deduction was not permissible under Sections 23(s) and 122(b)(2)(C) of the Internal Revenue Code of 1939, and accordingly sustained the Commissioner's disallowance of the deduction. (R. 36-45.) The Court of Appeals affirmed. (Pet. 13-29.)

ARGUMENT

The decision below is correct and is not in direct conflict with any other decisions. Legislative changes in the applicable statute, moreover, have rendered the question presented of diminishing importance.

1. Section 23(s) of the Internal Revenue Code of 1939 (Appendix, *infra*, pp. 12-14) authorizes a "net operating loss deduction computed under section 122." The latter section (Section 122(b) and (c), Appendix, *infra*, pp. 12-14) in turn provides that, "If * * * the taxpayer has a net operating loss" for a designated taxable year, the loss may, with certain adjustments, be carried backward or

forward as a deduction against income earned in other years.

Relying on these provisions, the taxpayer corporation claims the right to carry over and deduct from its income for the taxable year here involved (1950 fiscal year) net operating losses sustained in prior years by three other corporations which, together with thirteen additional corporations, were merged into it. The courts below, sustaining the Commissioner's determination, held that the pre-merger losses of the three merged corporations were not deductible from taxpayer's post-merger income from the new consolidated enterprise. Their decision is plainly in accord with the applicable statutory provisions. Section 122(b)(2)(C) explicitly confines the privilege of carrying over a net operating loss from one year to another to "the taxpayer" who sustained the loss. The losses which taxpayer here seeks to carry over and deduct were not sustained by it. They were sustained by three other corporations which were merged into it and were no longer in existence during the taxable year here involved.

The decision below is also in accord with this Court's decision in *New Colonial Co.* v. *Helvering*, 292 U.S. 435. It was there held that a corporation which acquired the assets and liabilities of another corporation in exchange for its stock pursuant to a reorganization was not entitled to carry over and deduct the predecessor corpora-

tion's loss under a statutory provision similar in all material respects to that here applicable. Notwithstanding that the successor corporation continued to operate the same business and had the same stockholders, it was denied the deduction since the two corporations were not the same "taxpayer" within the purview of the statute. Pointing out (pp. 440-441) that the words of the statute were "plain and free from ambiguity," the Court stated that "they mean that the taxpayer who sustained the loss is the one to whom the deduction shall be allowed."

The instant case presents an *a fortiori* situation for denial of the claimed deduction. Here the taxpayer corporation not only was a different taxpayer from the one which sustained the loss, but—unlike the successor corporation in *New Colonial*—it did not even carry on the same business as that of its predecessor. It acquired the assets of three separate retail stores whose businesses were unprofitable, combined them with those of thirteen other stores whose businesses were profitable, and now seeks to offset against the profits of the new combined enterprise the losses sustained by the three losing ventures. (R. 16-19.) Moreover, each of the three stores whose losses taxpayer now seeks to carry over and deduct from the income of the new enterprise continued to have losses during the taxable year (R. 19), so that in the absence of the merger there would have been

no operating loss deduction. In effect, taxpayer is seeking solely by virtue of the merger to create a right to a net operating loss deduction which would not otherwise have existed.

2. The two cases upon which taxpayer relies for conflict are readily distinguishable, as the court below pointed out. (Pet. 18-21, 25-26.)

In *Stanton Brewery* v. *Commissioner*, 176 F. 2d 573 (C.A. 2d), the first case with which taxpayer asserts conflict (Pet. 5, 6-8), an operating company was merged with a parent holding company, the business carried on after the merger was substantially the same as that theretofore carried on by the operating company, and even without the merger the latter would have been entitled to the claimed carry-over of an unused excess profits credit. Here sixteen separate operating corporations conducting sixteen separate stores were merged into a seventeenth corporation, so that the business thereafter carried on was substantially different, and taxpayer is attempting to deduct pre-merger losses of three of the stores from the post-merger income of the other stores. Moreover, since these three stores continued to operate at a loss after the merger, taxpayer is claiming a tax benefit to which it admittedly would not have been entitled without the merger. The court below accordingly considered the instant case distinguishable from *Stanton* for the reason (Pet. 21) that there the court was dealing

with "essentially a continuing enterprise"—a feature conspicuously absent here.

Nor is there any direct conflict between the decision below and *E. & J. Gallo Winery* v. *Commissioner*, 227 F. 2d 699 (C.A. 9th), the other case upon which taxpayer relies. (Pet. 5, 8-10.) As the court below observed (Pet. 25-26), although the *Gallo* opinion does not disclose "whether or not there was involved a continuing enterprise" in that case,[1] the court in *Gallo* places primary emphasis on the *Stanton* decision. The court below concluded (Pet. 26) that "Apparently the *Gallo* and *Stanton* cases stand on the same footing," thus viewing both those cases as distinguishable from this one for the same reasons. Furthermore, it does not appear from the *Gallo* opinion whether the predecessor corporation in that case would have been entitled to the claimed deduction in the absence of the merger. As pointed out above, had there been no merger in the instant case, the three corporations which sustained the losses in question here would not have been entitled to a deduction based on those losses.

In short, in view of these significant differences between this case and the *Stanton* and *Gallo* cases, the decision below cannot be said to create a real

[1] We note that Government counsel in the *Gallo* case, both in the Tax Court and in the Court of Appeals, did not urge any "continuing enterprise" test as a basis of decision but instead contended that the *Stanton* case should not be followed.

conflict. Indeed, it was on the ground that no direct conflict exists that the Commissioner refrained from applying for certiorari in those cases.[2]

3. While there are a number of cases still pending which involve the general question here presented, the basis for future litigation has been largely removed by virtue of legislative changes in the applicable provisions of the taxing statute.

Insofar as the carry-over or carry-back of an unused excess profits credit is concerned—the issue involved in the *Stanton* and *Gallo* cases—the World War II Excess Profits Tax Act (Subchapter E of Chapter 2 of the Internal Revenue Code

---

[2] The decision below was entered before expiration of the time to apply for certiorari in the *Gallo* case, and the Government obtained an extension of time until April 7, 1956, in order to consider the advisability of applying for certiorari in that case in the light of the decision below. After consideration, it was concluded that no petition should be filed because of the absence of a conflict. Nor has a petition been filed by the Government in *Koppers Co.* v. *United States*, 134 F. Supp. 290 (C. Cls.), which presents a similar question and follows *Stanton*. However, the Government has obtained an extension of time for filing a petition in the *Koppers* case until June 29, 1956, because of the possibility that a conflict may be created by the pending case of *Newmarket Manufacturing Co.* v. *United States*, awaiting decision by the First Circuit Court of Appeals. The decision of the District Court in that case is reported at 130 F. Supp. 706 (D. Mass.). Although similar in some respects, the question presented in *Newmarket* is different in that the net operating loss in issue was sustained by the *successor* corporation which seeks to carry-back the loss as an offset to tax liability of its predecessor.

of 1939) was repealed for taxable years beginning after 1945 by Section 122 of the Revenue Act of 1945, c. 453, 59 Stat. 556, while the Korean War Excess Profits Tax Act of 1950 (Subchapter D of Chapter 1) by its terms expired as to taxable years beginning after 1953. And insofar as the carry-over of a net operating loss is concerned—the issue here presented—the problem has likewise lost much of its importance by reason of changes enacted in the Internal Revenue Code of 1954, applicable to taxable years beginning after 1953. Section 381 of the 1954 Code permits a successor corporation in a tax-free reorganization to carry over various tax benefits (including a net operating loss) which would have been available to the predecessor, provided certain enumerated conditions are met; while companion Section 382 places "Special Limitations on Net Operating Loss Carryovers," even where the conditions specified in Section 381 are met. See H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 41-42 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4066-4067).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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May, 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * *

(s) [as added by Section 211, Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 122 [as added by Section 211, Revenue Act of 1939, *supra*]. *Net Operating Loss Deduction.*

(a) [as amended by Section 105, Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [as amended by Section 215, Revenue Act of 1950, c. 994, 64 Stat. 906] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—

(A) *Loss for Taxable Year Beginning Before 1950.*—If for any taxable year be-

ginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year * * *.

* * *

(2) *Net operating loss carry-over.*—

* * *

(C) [as added by Section 330, Revenue Act of 1951, c. 521, 65 Stat. 452] *Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950.*—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years * * *.

* * *

(c) [as amended by Sections 105(c)(3)(B) and 153(b) of the Revenue Act of 1942, *supra*, and Section 121(g)(2) of the Revenue Act

of 1950, *supra*] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d)(1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income (computed without such deduction and without the credits provided in sections 26(h) and (i));

* * *

(26 U.S.C. 1952 ed., Sec. 122.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939.

Sec. 29.122-1. *Net Operating Loss Deduction*—(*a*) *General.*—Section 122 provides the rules for the computation of the net operating loss deduction allowed by section 23(s). The net operating loss deduction is the aggregate of the net operating loss carry-overs and carry-backs to the taxable year, reduced by certain adjustments to prevent the deduction of losses absorbed by income not taxed.

* * *

(b) [As amended by T. D. 5963, 1953-1 Cum. Bull. 197] *Steps in computation of net operating loss deduction.*—There are three

steps in the ascertainment of the net operating loss deduction. The first step is the computation of the net operating loss, if any, for any preceding or succeeding taxable year from which a net operating loss may be carried forward or carried back to the current taxable year. The second is the computation of the net operating loss carry-overs to the taxable year from such preceding taxable years and the computation of the net operating loss carry-backs to the taxable year from such succeeding taxable years. The third is the conversion of the aggregate of such net operating loss carry-overs and carry-backs into the net operating loss deduction.

* * *

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INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and Regulations involved	2
Statement	2
Summary of argument	4
Argument:	
The courts below correctly held that taxpayer corporation is not entitled to deduct from its own income for the taxable year here involved net operating losses sustained in prior taxable years by other corporations which were merged into it	8
A. Since taxpayer corporation is not the taxable entity which sustained the losses, it is not entitled to carry over and deduct the losses	9
1. Under Sections 23 (s) and 122 of the 1939 Code, the deduction of a net operating loss by way of carry-back or carry-over is available only to the same taxpayer who sustained the loss	9
2. Taxpayer corporation is not the same taxpayer as the predecessor corporations whose losses it seeks to carry over and deduct	19
3. Taxpayer corporation is not the same taxable entity as its predecessors merely because it acquired the predecessors' assets by a merger rather than through some other type of reorganization	28
B. Even if regarded as the same taxable entity as its predecessors, taxpayer is not entitled to the claimed operating loss deduction since its business was not the same	41
Conclusion	47
Appendix	48

CITATIONS

Cases:

	Page
Alaska Salmon Co. v. *Commissioner*, 39 B. T. A. 455	26
Algrosa Watch Corp. v. *Commissioner*, 11 T. C. 240	41
American Gas & Electric Co. v. *United States*, 17 Supp. 151	35, 37
American Gas & Elec. Co. v. *Commissioner*, 85 F. 2d 527	35
Athol Mfg. Co. v. *Commissioner*, 54 F. 2d 230	24, 37
Bowman Hotel Corp. v. *Commissioner*, 24 B. T. A. 1193	26
Brandon Corp. v. *Commissioner*, 71 F. 2d 762	24
Burnet v. *Harmel*, 287 U. S. 103	30
Burnet v. *Sanford & Brooks Co.*, 282 U. S. 359	11
California Casket Co. v. *Commissioner*, 19 T. C. 32	25, 29
Cem Securities Corp. v. *Commissioner*, 72 F. 2d 295	24
Commissioner v. *Flowers*, 326 U. S. 465	10
Commissioner v. *Phipps*, 336 U. S. 410	21
Commonwealth Title Co. v. *Rothensies*, 124 F. Supp. 274	24
Deputy v. *duPont*, 308 U. S. 488	10
Donohue v. *United States*, 112 F. Supp. 660	25
Follansbee Steel Corp. v. *United States*, 109 F. Supp. 635	25
Founders Central Co. v. *Hoey*, 300 U. S. 268	34
Gallo, E. J., Winery v. *Commissioner*, decided April 17, 1953 (T. C.)	25, 29
Gallo, E. J., Winery v. *Commissioner*, 227 F. 2d 699	25, 28, 29, 33, 34, 43
Gregory v. *Helvering*, 293 U. S. 465	20
Heiner v. *Mellon*, 304 U. S. 271	11
Helvering v. *Metro. Edison Co.*, 306 U. S. 522	6, 35, 38, 39, 40
Helvering v. *Reynolds*, 313 U. S. 428	40
Helvering v. *Southwest Corp.*, 315 U. S. 194	40
Helvering v. *Stuart*, 317 U. S. 154	30
Helvering v. *Wilshire Oil Co.*, 308 U. S. 90	40
Higgins v. *Smith*, 308 U. S. 473	20
Interstate Transit Lines v. *Commissioner*, 319 U. S. 590	10, 21, 43
Jones v. *Noble Drilling Co.*, 135 F. 2d 721	37
Koppers Co. v. *United States*, 134 F. Supp. 290	28, 33, 43

Cases—Continued

	Page
Lyeth v. *Hoey*, 305 U. S. 188	30
May Oil Burner Corp. v. *Commissioner*, 71 F. 2d 644	24
McDonald v. *Commissioner*, 323 U. S. 57	10
Moline Properties v. *Commissioner*, 319 U. S. 436	20, 30, 34, 35
National Carbide Corp. v. *Commissioner*, 336 U. S. 422	21, 30, 34, 35
National Securities Corp. v. *Commissioner*, 137 F. 2d 600, certiorari denied, 320 U. S. 794	21
New Colonial Co. v. *Helvering*, 66 F. 2d 480	20
New Colonial Co. v. *Helvering*, 292 U. S. 435	5, 6, 10, 11–13, 16, 20, 22, 23, 27, 30, 32, 33, 34, 35, 39, 40, 47
Newmarket Manufacturing Co. v. *United States*, 130 F. Supp. 706	25
Newmarket Manufacturing Co. v. *United States*, 233 F. 2d 493	25, 28, 33, 35, 42
New York Cent. R. Co. v. *Commissioner*, 79 F. 2d 247, certiorari denied, 296 U. S. 653	35, 36, 37
Oswego Falls Corp. v. *Commissioner*, 26 B. T. A. 69, affirmed, 71 F. 2d 673	26
Pennsylvania Co., Etc. v. *Commissioner*, 75 F. 2d 719	24
Phillips v. *Commissioner*, 283 U. S. 589	31
Phillips-Jones Corp. v. *Parmley*, 302 U. S. 233	31
Planters Oil Co. v. *Hopkins*, 286 U. S. 332	47
Reo Motors v. *Commissioner*, 338 U. S. 442	10
Rohmer v. *Commissioner*, 153 F. 2d 61, certiorari denied, 328 U. S. 862	27
Saenger v. *Commissioner*, 38 B. T. A. 1295	26
Security Mills Co. v. *Commissioner*, 321 U. S. 281	11
Shreveport Producing & Refining Co. v. *Commissioner*, 71 F. 2d 972, certiorari denied, 293 U. S. 616	24
Standard Paving Co. v. *Commissioner*, 13 T. C. 425, affirmed, 190 F. 2d 330, certiorari denied, 342 U. S. 869	24, 29
Stanton Brewery v. *Commissioner*, 176 F. 2d 573	26, 29, 30, 32, 33, 34, 42
Trahern Pump Co. v. *Commissioner*, 27 B. T. A. 363	26
Trinco Industries v. *Commissioner*, 22 T. C. 959	25, 29, 47
United States v. *Gilbert Associates*, 345 U. S. 361	30
United States v. *Lewis*, 340 U. S. 590	11
United States v. *Olympic Radio & Television*, 349 U. S. 232	10

Cases—Continued Page

United States v. *Pelzer*, 312 U. S. 399 30
Weber Flour Mills Co. v. *Commissioner*, 82 F. 2d 764 24
Western Maryland Ry. Co. v. *Commissioner*, 33 F. 2d 695 35
Woolford Realty Co. v. *Rose*, 286 U. S. 319 47

Statutes:
Internal Revenue Code of 1939:
Sec. 13 (b) (26 U. S. C. 1952 ed., Sec. 13 (b)) 19
Sec. 15 (b) (26 U. S. C. 1952 ed., Sec. 15 (b)) 19
Sec. 23 (p) (26 U. S. C. 1952 ed., Sec. 23 (p)) 40
Sec. 23 (s) (26 U. S. C. 1952 ed., Sec. 23 (s)) 8, 9, 48
Sec. 112 (b) (26 U. S. C. 1952 ed., Sec. 112 (b)) 17
Sec. 112 (g) (26 U. S. C. 1952 ed., Sec. 112 (g)) 17, 31
Sec. 113 (a) (26 U. S. C. 1952 ed., Sec. 113 (a)) 26
Sec. 122 (26 U. S. C. 1952 ed., Sec. 122) 5, 8, 9, 10, 13, 17, 26, 30, 41
Sec. 122 (a) (26 U. S. C. 1952 ed., Sec. 122 (a)) 10, 48
Sec. 122 (b) (26 U. S. C. 1952 ed., Sec. 122 (b)) 10, 11, 48
Sec. 122 (c) (26 U. S. C. 1952 ed., Sec. 122 (c)) 10, 49
Sec. 122 (d) (26 U. S. C. 1952 ed., Sec. 122 (d)) 10
Sec. 129 (26 U. S. C. 1952 ed., Sec. 129) 46
Sec. 141 (26 U. S. C. 1952 ed., Sec. 141) 19
Sec. 311 (26 U. S. C. 1952 ed., Sec. 311) 26, 31
Internal Revenue Code of 1954:
Sec. 381 (26 U. S. C. 1952 ed., Supp. II, Sec. 381) 18, 45
Sec. 382 (26 U. S. C. 1952 ed., Supp. II, Sec. 382) 18, 42, 45
Act of July 15, 1947, c. 249, 61 Stat. 324, Sec. 1 16
Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 204 13
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 204 (b) 11, 13
Revenue Act of 1939, c. 247, 53 Stat. 862, Sec. 211 (26 U. S. C. 1952 ed., Secs. 23 (s) and 122) 14, 48
Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 153 (a) (26 U. S. C. 1952 ed., Sec. 122 (b)) 15
Revenue Act of 1943, c. 63, 58 Stat. 21, Sec. 128 (a) (26 U. S. C. 1952 ed., Sec. 129) 46

Miscellaneous:
H. Conference Rep. No. 2543, 83d Cong., 2d Sess., pp. 39–41 (3 U. S. C. Cong. & Adm. News (1954) 5280, 5298–5301) 18, 46

Miscellaneous—Continued

	Page
H. Rep. No. 855, 76th Cong., 1st Sess., pp. 9–10 (1939–2 Cum. Bull. 504, 510–511)	14
H. Rep. No. 871, 78th Cong., 1st Sess., pp. 24, 49–50 (1944 Cum. Bull. 901, 938)	46
H. Rep. No. 624, 80th Cong., 1st Sess., p. 1	16
H. Rep. No. 1337, 83d Cong., 2d Sess.:	
Pp. 41–42 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4066–4067)	18, 45
Pp. A135–A145 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4273–4284)	18, 19
P. S. 62 (May 5, 1950, 1950 C. C. H., par. 6118)	40
Schorr, *Taxable Dividends in Reorganization Cases*, New York University Institute on Federal Taxation, Seventh Annual (1948)	31
S. Rep. No. 617, 65th Cong., 3d Sess., p. 7 (1939–1 Cum. Bull. (Part 2) 117, 121–122)	13
S. Rep. No. 627, 78th Cong., 1st Sess., pp. 26, 58–61 (1944 Cum. Bull. 973, 1016–1017)	46
S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 52–53, 275–287 (3 U. S. C. Cong. & Adm. News (1954) 4621, 4683–4684, 4914–4925)	18, 19, 45
Treasury Regulations 111, Secs. 29.52–1, 29.122–1, 29.311–1	10, 19, 31, 56

In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 64

LIBSON SHOPS, INC., PETITIONER

v.

GUSTAVE F. KOEHLER, DISTRICT DIRECTOR OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the District Court (R. 32–43) is not officially reported. The opinion of the Court of Appeals (R. 47–60) is reported at 229 F. 2d 220.

JURISDICTION

The judgment of the Court of Appeals was entered on January 19, 1956. (R. 61.) An order denying taxpayer's petition for rehearing was entered on February 16, 1956. (R. 61.) The petition for a writ of certiorari was filed on April 14, 1956, and was granted on June 4, 1956. (R. 62.) The jurisdiction of this Court rests upon 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the taxpayer corporation is entitled, under Sections 23 (s) and 122 of the Internal Revenue Code of 1939, to carry over and deduct from its own income for the taxable year here involved net operating losses sustained in prior taxable years by other corporations which were merged into it.

STATUTE AND REGULATIONS INVOLVED

The statute and Regulations involved are Sections 23 (s), 122 (a), (b) (1) (A) and (2) (C), and (c) of the Internal Revenue Code of 1939, and Section 29.122-1 (a) and (b) of Treasury Regulations 111. These are set forth in the Appendix, *infra*, pp. 48–50.

STATEMENT

The material facts, which the District Court found (R. 33) to be as stipulated by the parties (R. 13–18), may be summarized as follows:

Taxpayer is a Missouri corporation organized in 1946 under the name of Libson Shops Management Corporation. (R. 14, 18.) It engaged in the business of providing management services for sixteen Missouri and Illinois corporations, each of which operated a store selling women's apparel at retail. (R. 14–15.) All of the outstanding stock of taxpayer and of each of the sixteen other corporations was owned, directly or indirectly, by the same eight individuals and in the same proportions. (R. 15.)

On August 1, 1949, pursuant to an agreement for merger under the laws of Missouri and Illinois, the sixteen separate operating corporations were merged

into the taxpayer corporation and dissolved. (R. 15, 30–32.) The merger agreement provided that taxpayer should continue as the surviving corporation under the name Libson Shops, Inc. (R. 22); and that new stock of the taxpayer, in revised amount and par value, should be issued in exchange, *pro rata*, for the stock of the merged corporations. (R. 24–26.) The agreement also enlarged taxpayer's business purposes. (R. 22–24.) After the merger, taxpayer operated the stores which had formerly been operated separately by the sixteen operating corporations, and which now constituted assets of the taxpayer. (R. 17.)

Prior to the merger, three of the operating corporations had sustained net operating losses from their respective businesses as follows: (1) Evanston Libson Shops, Inc., $8,115.11 for the calendar year 1948, and $6,422.28 for the period January 1 to July 31, 1949; (2) Lawrence Libson Shops, Inc., $2,770.42 for its fiscal year ended July 31, 1949, and an unused carry-over credit of $245.03; (3) Hampton Libson Shops, Inc., $4,879.92 for its fiscal year ended July 31, 1949. (R. 16.) In the year following the merger (the taxable year here involved, ended July 31, 1950), each of the businesses formerly operated by these three corporations continued to sustain a net operating loss. (R. 16–17.)

In its income tax return for the first taxable year after the merger, ended July 31, 1950, taxpayer reported a net income of $46,794.70. From this figure it claimed a deduction, by way of carry-over, of the

total net operating losses ($22,432.76) sustained before the merger by three of the operating corporations, as set forth above. (R. 16–17.)

The Commissioner disallowed the claimed deduction, and taxpayer paid the resulting tax deficiency. (R. 14.) Taxpayer duly filed a claim for refund, which was disallowed, and then instituted the present litigation. (R. 17–18.) The District Court held that the claimed net operating loss deduction was not permissible under Sections 23 (s) and 122 of the Internal Revenue Code of 1939, and accordingly sustained the Commissioner's disallowance of the deduction. (R. 33–41.) The Court of Appeals affirmed. (R. 47–60.)

SUMMARY OF ARGUMENT

Taxpayer corporation claims the right, under Sections 23 (s) and 122 of the Internal Revenue Code of 1939, to carry over and deduct from its income for the taxable year here involved net operating losses sustained in prior years by three other corporations merged into it. The assets and liabilities of the three corporations which sustained the losses, together with the assets and liabilities of thirteen other operating corporations (in all, sixteen separate stores), were transferred to the taxpayer corporation pursuant to the merger. After the merger, the three ailing businesses continued to have losses, while those formerly conducted by the other merged corporations continued to have profits, resulting in a net income from all of the businesses combined. The decision below, sustaining the Commissioner's disallowance of the claimed

carry-over, is supported by the terms of the statute, its legislative history, and the controlling precedents.

Section 122 authorizes "the taxpayer" to carry over and deduct from the income of a current taxable year a net operating loss sustained in a preceding year. It is to be strictly construed not only because it grants a tax deduction, but because it marks a sharp departure from the annual accounting rule. The provisions of the statute, their legislative history, and the relevant decisions make it clear that the carry-over privilege is not available unless two conditions are met: (1) The one claiming the privilege must be the same "taxpayer", *i. e.*, the same taxable entity, as the one which sustained the prior year's loss; and (2) there must be continuity of the business enterprise, *i. e.*, the current year's income against which the taxpayer seeks to offset the prior year's loss must be derived from the operation of substantially the same business as that which produced the loss. As the courts below held, neither of those conditions has here been met.

That taxpayer corporation is not the same "taxpayer" as the transferor corporations which were merged into it, follows from the established doctrine of corporate entity—which requires recognition of every corporation for federal income tax purposes—and this Court's decision in *New Colonial Co.* v. *Helvering*, 292 U. S. 435, applying that doctrine in interpreting a statutory provision similar in all material respects to that here involved. In *New Colonial*, this Court held that a corporation which acquired the

assets and liabilities of another corporation pursuant to a reorganization was not entitled to carry over and deduct the transferor corporation's loss because the two corporations were not the same "taxpayer" within the purview of the statute, and it so held notwithstanding the fact that the business and stockholders of each remained the same. The rationale of *New Colonial* (and of cases following it) applies to a merger type of reorganization, such as was here effected.

The cases relied upon by taxpayer, insofar as they hold that a corporation resulting from a merger is the same taxpayer as its dissolved predecessors for purposes of applying the net operating loss provisions of the federal taxing statute, run counter to this Court's reasoning in *New Colonial* and are based upon an untenable distinction between merger and non-merger types of reorganization. Since taxpayer is not the corporation which sustained the operating loss in question, it is no more entitled to the benefit of the carry-over privilege than was the successor corporation in *New Colonial*. Decisions allowing a corporation resulting from a merger to deduct unamortized discount on bond indebtedness (*e. g., Helvering* v. *Metro. Edison Co.*, 306 U. S. 522), also relied upon by taxpayer, deal with post-merger losses sustained by the successor corporation itself; they are not inconsistent with the *New Colonial* decision, and they furnish no authority for the proposition that the net operating loss carry-over privilege is assignable from one corporate taxpayer to another by way

of merger. Nor is there any inconsistency, as taxpayer charges, between the Government's position in this case and in others involving the same question.

Even assuming *arguendo* that the loss carry-over privilege may be extended to a corporation other than the one which sustained the loss, taxpayer still cannot prevail since it has not met the continuity of enterprise test. That test has been applied in the very cases relied upon by taxpayer, and taxpayer's failure to satisfy the requirement serves to distinguish this case from those. Here, the taxpayer corporation acquired the assets of three separate retail stores whose businesses were unprofitable, combined them with those of thirteen other stores whose businesses were profitable, and now seeks to offset against the profits of the new combined enterprise the losses sustained by the three losing ventures.

What is more, each of the three ailing businesses whose losses taxpayer now seeks to carry over and deduct from the income of the new enterprise continued to have losses during the taxable year, so that in the absence of the merger there admittedly would have been no right to a loss carry-over. Thus even if, as taxpayer contends, it stands in the shoes of the merged corporations, it would not be entitled to the claimed deduction. In effect, taxpayer is seeking, solely by virtue of the merger, to create a right to a net operating loss deduction which would not otherwise have existed. It is clear that Congress did not intend such a result.

ARGUMENT

THE COURTS BELOW CORRECTLY HELD THAT TAXPAYER CORPORATION IS NOT ENTITLED TO DEDUCT FROM ITS OWN INCOME FOR THE TAXABLE YEAR HERE INVOLVED NET OPERATING LOSSES SUSTAINED IN PRIOR TAXABLE YEARS BY OTHER CORPORATIONS WHICH WERE MERGED INTO IT

The taxpayer is a Missouri corporation orginally organized in 1946 to supervise and manage other corporations, owned by the same stockholders, which operated clothing stores in Missouri and Illinois. On August 1, 1949, the operating corporations—sixteen in number—were merged into taxpayer, pursuant to the laws of Missouri and Illinois; and taxpayer continued to operate, as a single enterprise, the stores theretofore separately operated by the merged corporations. Before the merger, three of the operating corporations had sustained net operating losses; and the businesses of these corporations continued to operate at a loss after taxpayer acquired them through the merger proceedings. Taxpayer, however, reported an over-all net income for the year succeeding the merger, and the question presented by this litigation is whether it is entitled to carry over and deduct from that net income, under Sections 23 (s) and 122 of the Internal Revenue Code of 1939 (Appendix, *infra*, pp. 48–50), the pre-merger net operating losses of the three ailing enterprises.

Both the District Court and the Court of Appeals have ruled that taxpayer is not entitled to the deduction, and we submit that their decision is correct. Only the taxpayer who actually sustains a net operating loss is entitled, under the relevant statutes and de-

cisions, to deduct that loss, by way of carry-over or carry-back, in computing his taxable income for years other than the year of loss. The taxpayer corporation in the case at bar is not the same taxpayer which sustained the net operating losses in question, and the claimed deduction has therefore been properly denied.

Alternatively, it is the Government's position that, even if the statute may properly be read as according the carry-over privilege to a taxpayer other than the one who sustained the loss, in any event it may not be construed as extending the privilege to one who carries on a business different from that which produced the loss. Here sixteen separate operating corporations conducting sixteen separate stores were merged into the taxpayer corporation, so that the business thereafter carried on was substantially different; yet taxpayer is attempting to deduct the pre-merger losses of three of the stores from the post-merger income of all of the stores combined. Indeed, since these three stores continued to operate at a loss after the merger, taxpayer is here claiming a tax benefit to which it concededly would not have been entitled in the absence of merger.

A. SINCE TAXPAYER CORPORATION IS NOT THE TAXABLE ENTITY WHICH SUSTAINED THE LOSSES, IT IS NOT ENTITLED TO CARRY OVER AND DEDUCT THE LOSSES

1. *Under Sections 23 (s) and 122 of the 1939 Code, the deduction of a net operating loss by way of carry back or carry-over is available only to the same taxpayer who sustained the loss*

Section 23 (s) of the Internal Revenue Code of 1939 authorizes a "net operating loss deduction computed under section 122." Section 122 in turn provides that

if "the taxpayer" has a net operating loss for a designated taxable year, the loss (with certain adjustments) may be carried back as a deduction against income earned in the two preceding years, and, to the extent not exhausted by the carry-back, be carried over as a deduction against income earned in the three succeeding years.[1]

The provisions of Section 122 must be examined in the light of the "now familiar rule that an income tax deduction is a matter of legislative grace and that the burden of clearly showing the right to the claimed deduction is on the taxpayer." *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590, 593. See also *McDonald* v. *Commissioner*, 323 U. S. 57, 60; *Commissioner* v. *Flowers*, 326 U. S. 465; *Deputy* v. *duPont*, 308 U. S. 488, 493. For "only as there is clear provision therefor can any particular deduction be allowed." *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440. See, also, the recent decision in *United States* v. *Olympic Radio & Television*, 349 U. S. 232, where this Court stated (p. 236):

> But as we have said before, "general equitable considerations" do not control the question of

[1] Determination of the net operating loss deduction involves three steps. The first is the computation of the net operating loss, if any, for the years preceding or succeeding the current taxable year. (Section 122 (a) and (d).) The second is the determination of the extent to which the losses may be used as a carry-over or carry-back to the current taxable year. (Section 122 (b).) The third step is the conversion of the aggregate of the permissible carry-overs and carry-backs into the net operating loss deduction. (Section 122 (c).) See Treasury Regulations 111, Section 29.122–1 (Appendix, *infra*, p. 50); *Reo Motors* v. *Commissioner*, 338 U. S. 442, 446–447.

> what deductions are permissible. *Deputy* v. *duPont, supra,* at 493. It may be that Congress granted less than some thought or less than was originally intended. We can only take the Code as we find it and give it as great an internal symmetry and consistency as its words permit.

This rule of strict construction takes on added significance here, since the allowance of a loss carry-over from one taxable year to another, for deduction purposes, marks a sharp departure from our established system of annual tax accounting periods. *Security Mills Co.* v. *Commissioner,* 321 U. S. 281; *United States* v. *Lewis,* 340 U. S. 590; *Burnet* v. *Sanford & Brooks Co.,* 282 U. S. 359; *Heiner* v. *Mellon,* 304 U. S. 271.

Nothing in the language of Section 122 suggests that Congress intended to permit one taxpayer to carry over (or carry back) and deduct operating losses of another taxpayer. Far from authorizing such a transfer, the language of the section would seem plainly to exclude it. Section 122 (b) (2) (C), the subsection invoked by taxpayer in the instant case, permits carry-over of a net operating loss from one year to another "[i]f * * * the taxpayer" sustained the loss. Thus the only "taxpayer" authorized to carry over a loss of a preceding taxable year and offset it against the income of a current taxable year is "the" taxpayer who had the loss.

Square authority for this interpretation is found in *New Colonial Co.* v. *Helvering, supra,* where this Court construed and applied the carry-over provision of the 1921 Revenue Act (c. 136, 42 Stat. 227, Section

204 (b)), which, in all material respects, was the same as the statutory provision here involved. The Court stated (pp. 440–441):

> The statutes pertaining to the determination of taxable income have proceeded generally on the principle that there shall be a computation of gains and losses on the basis of a distinct accounting for each taxable year; and only in exceptional situations, clearly defined, has there been provision for an allowance for losses suffered in an earlier year. *Not only so, but the statutes have disclosed a general purpose to confine allowable losses to the taxpayer sustaining them, i. e., to treat them as personal to him and not transferable to or usable by another.*
>
> * * * * *
>
> When section 204 (b) is read with the general policy of the statutes in mind, as it should be, we think it cannot be regarded as giving any support to the deduction here claimed. It brings into the statutes an exceptional provision declaring that where for one year "any taxpayer has sustained a net loss" the same shall be deducted from the net income of "the taxpayer" for the succeeding taxable year; and, if such loss be in excess of the income for that year, the excess shall be deducted from the net income for the next succeeding taxable year. Its words are plain and free from ambiguity. *Taken according to their natural import they mean that the taxpayer who sustained the loss is the one to whom the deduction shall be allowed. Had there been a purpose to depart from the general policy in that regard, and to make the right to the deduction transferable or available to others than the*

> *taxpayer who sustained the loss, it is but reasonable to believe that purpose would have been clearly expressed. And as the section contains nothing which even approaches such an expression, it must be taken as not intended to make such a departure.* [Emphasis added.]

The provisions of Section 122, like those of Section 204 (b) of the 1921 Act, must be read in the light of the general policy of the statutes "to confine allowable losses to the taxpayer sustaining them, i. e., to treat them as personal to him and not transferable to or usable by another." And there is obviously no clear expression in Section 122 of a purpose to depart from that general policy. To the contrary, the section focuses upon "the taxpayer"—both as to the computation of net operating losses, and as to the carry-back and carry-over of such losses for deduction purposes. It follows that only "the taxpayer" sustaining the net operating loss can deduct it, by way of carry-back or carry-over, from the income of years other than the year of loss.

This conclusion is supported not only by the *New Colonial* decision but by the pertinent legislative history. The privilege of carrying over a net operating loss from one year to another was first allowed by Section 204 of the Revenue Act of 1918, c. 18, 40 Stat. 1057. The Senate Committee Report accompanying the 1918 bill stated (S. Rep. No. 617, 65th Cong., 3d Sess., p. 7 (1939–1 Cum. Bull. (Part 2) 117, 121–122)):

> At the present time no recognition is given to net losses; that is, if in any year the losses and expenses of a taxpayer exceed his gross in-

come the excess (or in other words, the net loss) can not be carried over into the next year. For purposes of taxation the settlement must be made upon the basis of each year's business by itself. The chief merit of the present plan is its simplicity of administration. But it does not adequately recognize the exigencies of business, and, under our present high rates of taxation, may often result in grave injustice. The committee has accordingly incorporated an amendment (section 204) which provides that under certain limitations net losses sustained in 1917 or in 1918 may be deducted in computing the net income of the taxpayer for the succeeding taxable year; that a net loss sustained in the future may be deducted from the net income of the preceding taxable year, and if it is in excess of the net income for such preceding taxable year, that such excess may be allowed as a deduction in computing the net income for the succeeding taxable year.

A net loss carry-over and carry-back were also allowed in the 1921, 1924, 1926 and 1928 Revenue Acts. Sections 23 (s) and 122 were added to the 1939 Code by Section 211 of the Revenue Act of 1939, c. 247, 53 Stat. 862, in order to restore the relief as it had existed under the 1928 Act. The committee report bearing upon the addition of Sections 23 (s) and 122 contained the following explanation (H. Rep. No. 855, 76th Cong., 1st Sess., pp. 9–10 (1939–2 Cum. Bull. 504, 510–511)):

> The bill, together with the committee amendments, permits taxpayers to carry over net operating business losses for a period of two years. Prior to the Revenue Act of 1932, such

> 2-year carry-over was allowed. * * * In the Revenue Act of 1932, the 2-year net loss carry-over was reduced to one year and in the National Industrial Recovery Act the net loss carry-over was entirely eliminated. As a result of the elimination of this carry-over, a business with alternating profit and loss is required to pay higher taxes over a period of years than a business with stable profits, although the average income of the two firms is equal. New enterprises and the capital-goods industries are especially subject to wide fluctuations in earnings. It is, therefore, believed that the allowance of a net operating business loss carry-over will greatly aid business and stimulate new enterprises.

As originally added to the 1939 Code, Section 122 provided for the computation and carry-over of net operating losses without expressly relating them to a given taxpayer. But Section 153 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, amended Section 122 (b), not only to allow loss carry-backs for the first time, but also to provide, as to both carry-backs and carry-overs, that it was the net operating losses of "the taxpayer" which could be so utilized.

In the light of this history, it is apparent that the loss carry-over privilege allowed by Section 122 and its predecessors was intended to permit a taxpayer whose business income fluctuated widely from year to year to average the income over a period of years, and thereby alleviate the occasional harsh effect of computing his income on an annual accounting basis. There was no intention, express or implied, to permit the averaging of business incomes of different taxpay-

ers. Congress authorized a deduction personal to a given taxpayer and nontransferable to any other taxpayer, as this Court held in *New Colonial Co. v. Helvering, supra.*

Congress apparently accepted this Court's 1934 decision in *New Colonial* as a correct interpretation of the statute, for it made no change in the net operating loss provisions insofar as they affect the question here presented. That Congress did not intend the Section 122 relief to apply generally in favor of a corporation acquiring the assets and liabilities of another corporation through a merger or other reorganization is affirmatively shown, moreover, by the fact that in 1947 it retroactively granted such relief *limited* to certain reorganized railroad corporations. Section 1 of the Act of July 15, 1947, c. 249, 61 Stat. 324. Significantly, the explanatory committee report stated (H. Rep. No. 624, 80th Cong., 1st Sess., p. 1):

> Under existing law, if a railroad corporation is reorganized in a receivership proceeding or in a proceeding under section 77 of the National Bankruptcy Act, as amended, *and the reorganization is effected through the organization of a new corporation,* any carry-overs of net operating losses or unused excess profits credits of the old corporation cannot be used by the new corporation. *The reorganized corporation is regarded as a different taxpayer from the old corporation.* Consequently, railroads coming out of receivership or bankruptcy proceedings are treated differently, *depending upon whether they can be reorganized under the same charter or under a new charter.* The bill removes this discrimination * * * and *the*

> *relief is limited* to railroad corporations as defined in section 77m of the National Bankruptcy Act. [Emphasis added.]

Thus, in clear terms, Congress recognized that a corporation emerging from a reorganization with a "new charter" is not the same taxpayer as its predecessor for purposes of applying the loss and credit carry-over provisions of the statute. Had Congress regarded a corporation acquiring the assets of a predecessor corporation as the same taxpayer for purposes of Section 122, there obviously would have been no need for the enactment of the 1947 statute. And since the special relief granted in 1947 was expressly limited to certain acquiring railroad corporations, it may not be extended by implication to other classes of acquiring corporations.

Enlargements of the relief allowed in Section 122 should be made by Congress, not by the courts. Congress was fully aware that the assets and liabilities of one corporation are often taken over by another corporation pursuant to a merger or consolidation or other kind of reorganization, resulting in termination of the separate corporate existence of the transferor.[2] Had Congress wished to extend the carry-over privilege accorded by Section 122 to a corporation which did not itself experience the net operating loss, but which acquired the business of another corporation which had the loss, it could readily and simply have

[2] Elsewhere in the 1939 Code Congress enacted elaborate provisions respecting the consequences flowing from corporate reorganizations, and it defined a reorganization as including statutory mergers or consolidations. Section 112 (b) (3), (b) (4) and (g) (26 U. S. C. Sec. 112 (b) (3), (b) (4) and (g)).

done so. It did do so—but with well-defined qualifications and limitations—in the Internal Revenue Code of 1954 which, of course, is not applicable to the case at bar.[*]

[*] Section 381 of the Internal Revenue Code of 1954, applicable to years after 1953, permits a successor corporation in a tax-free reorganization to carry over various tax benefits (including a net operating loss) which would have been available to the predecessor, provided certain enumerated conditions are met. Companion Section 382 places "Special Limitations on Net Operating Loss Carryovers," even where the conditions specified in Section 381 are met. The Ways and Means Committee report accompanying the 1954 Code states in part with reference to these sections (H. Rep. No. 1337, 83d Cong., 2d Sess., pp. 41–42 (3 U. S. C. Cong. & Adm. News (1954) 4017, 4066–4067):

"Present law makes no provision for the transfer from one corporation to another, in a tax-free merger or consolidation, of the major tax benefits, privileges, elective rights, and obligations which were available to the predecessor. These include such items as loss carryovers, * * *.

* * * * *

"The bill provides for the carryover of about 16 specific tax attributes or items from one corporation to another in certain tax-free reorganizations, * * *.

"* * * At the same time the new provision makes it difficult to escape the tax consequences of the law by means of a legal artifice such as liquidation and reincorporation or merger into another corporation."

See also pages A135–A145 of H. Rep. No. 1337, *supra* (3 U. S. C. Cong. & Adm. News (1954) 4017, 4273–4284); S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 52–53, 275–287 (3 U. S. C. Cong. & Adm. News (1954) 4621, 4683–4684, 4914–4925); H. Conference Rep. No. 2543, 83d Cong., 2d Sess., pp. 39–41 (3 U. S. C. Cong. & Adm. News (1954) 5280, 5298–5301). Contrary to taxpayer's assertion (Br. 6, 18), it is far from clear that the deduction in controversy would have been allowable under the 1954 Code. But even assuming that it were, there is no basis for taxpayer's further assumption that the 1954 Code confirmed, rather than changed, the pre-existing law. The committee reports caution that "No inference is to be drawn from the enactment of this section [Section

In sum, under the statutory provisions which control this case, the taxpayer corporation can carry over and deduct the net operating losses in question only if it was "the taxpayer," *i. e.*, the same taxable entity which sustained those losses.

2. *Taxpayer corporation is not the same taxpayer as the predecessor corporations whose losses it seeks to carry over and deduct*

The doctrine of corporate entity—that every corporation is a separate taxable unit—forms an integral part of the federal income tax system. Sections 13 (b) and 15 (b) of the Internal Revenue Code of 1939 impose a normal tax and surtax, respectively, upon the net income of "every corporation," and (with exceptions not here relevant[4]) "every corporation" subject to tax is required by Section 52 (a) to file a return depicting its gross income and deductions. See, also, Sections 29.52–1 of Treasury Regulations 111. No exception is made in the case of a merger, consolidation, or other type of reorganization. Furthermore, any taxpayer not in existence during the whole of an annual accounting period is required by Section 47 (g) to file a return "for the fractional part of the year during which the taxpayer

381] whether any item or tax attribute may be utilized by a successor or a predecessor corporation under existing law." H. Rep. No. 1337, *supra*, p. A135; S. Rep. No. 1622, *supra*, p. 277. At any rate, since the 1954 Code provisions are not applicable, there is no need to inquire whether the conditions precedent to the carry-over there imposed are met in this case, or, if met, to ascertain the limited extent to which the losses might be deductible.

[4] See, *e. g.*, the provisions of Section 141 relating to consolidated returns.

was in existence." These provisions have always been recognized as demanding separate returns by a predecessor and successor corporation (including those participating in a merger) of their respective incomes for the periods covering their respective lives. A transfer by way of merger or other reorganization does not have the effect of amalgamating the separate taxable entities of the transferor and transferee corporations.[5]

The doctrine of corporate entity requires recognition of every corporation as a separate taxable entity, so long as it has some business purpose.[6] Thus this Court said in *Moline Properties* v. *Commissioner*, 319 U. S. 436, 438–439:

> The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal or undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on

[5] Indeed, in the instant case, taxpayer and its predecessors regarded themselves as separate taxable entities, despite the merger, since separate returns for a short taxable year ending with the merger (July 31, 1949) were filed on behalf of those predecessors which had been filing returns on a calendar year basis. (R. 16.) If, as taxpayer now contends, the taxable identity of the predecessors was continued in it as successor, then a single return covering the calendar year 1949 and reflecting their combined operations for that year should have been filed. See *New Colonial Co. v. Helvering*, 66 F. 2d 480, 481–482 (C. A. 2d), affirmed, 292 U. S. 435.

[6] The rule may be disregarded only where there is an express legislative exception, or where the corporate form is a sham or unreal. *Higgins* v. *Smith*, 308 U. S. 473, 477–78; *Gregory* v. *Helvering*, 293 U. S. 465.

> of business by the corporation, the corporation remains a separate taxable entity. *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 442; *Deputy* v. *duPont*, 308 U. S. 488, 494. In *Burnet* v. *Commonwealth Improvement Co.*, 287 U. S. 415, this Court appraised the relation between a corporation and its sole stockholder and held taxable to the corporation a profit on a sale to its stockholder. This was because the taxpayer had adopted the corporate form for purposes of his own. The choice of the advantages of incorporation to do business, it was held, required the acceptance of the tax disadvantages.

This doctrine of separate tax identity applies, of course, not only as between the corporation and its stockholders, but as between commonly owned corporations conducting similar businesses. Thus, a parent corporation and its wholly-owned subsidiaries are separate taxpayers; and the parent may not, by any device, report as its own income the income of its subsidiaries. *National Carbide Corp.* v. *Commissioner*, 336 U. S. 422. Similarly, a parent corporation may not deduct its subsidiary's operating deficit. *Interstate Transit Lines* v. *Commissioner*, 319 U. S. 590. See also *Commissioner* v. *Phipps*, 336 U. S. 410; *National Securities Corp.* v. *Commissioner*, 137 F. 2d 600 (C. A. 3d), certiorari denied, 320 U. S. 794.

The doctrine of corporate entity comes into play with full force for purposes of applying the net operating loss deduction provisions, as was made clear by this Court in its landmark decision in the *New Colonial* case. There, the taxpayer corporation had taken over all the assets and liabilities of another

corporation in exchange for its stock, pursuant to a reorganization; and the question was whether the taxpayer could deduct, by way of carry-over, a net operating loss of the predecessor corporation. This Court held (1) that only the taxpayer who sustains a net operating loss is entitled to carry over the loss as a deduction; (2) that the taxpayer corporation was *not* the same taxable entity as the predecessor, although it continued to operate the same business and had the same stockholders; and (3) that, accordingly, it was not entitled to carry over the net operating loss of the predecessor. In disposing of the taxpayer's contention that it was the same "taxpayer" as the predecessor corporation, because it had the same assets, stockholders, and business, and was therefore for all practical purposes the same entity, this Court said (292 U. S. at 441–442):

> This is not in accord with the view on which the stockholders and creditors proceeded when the new company was brought into being. They deserted the old company and turned to the new one because they regarded it as a distinct corporate entity and therefore free from difficulties attending the old one. Having sought and reaped the advantages incident to the change, it well may be that they would encounter some embarrassment in now objecting to an incidental and remote disadvantage such as is here in question. But, be this as it may, we are of opinion that in law and in fact the two corporations were not identical but distinct. This was plainly implied in the transfer of the assets and business from one to the other. That transaction was voluntary and contractual, not

by operation of law. Thereafter neither corporation had any control over the other; the old corporation had no interest in the assets or business, and the chance of gain and the risk of loss were wholly with the new one. Thus the contention that the two corporations were practically the same entity and therefore the same taxpayer has no basis, unless, as the petitioner insists, the fact that the stockholders of the two corporations were substantially the same constitutes such a basis.

As a general rule a corporation and its stockholders are deemed separate entities and this is true in respect of tax problems. * * * in this case we find * * * nothing taking it out of the general rule. On the contrary, we think it a typical case for the application of that rule.[7]

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[7] To be sure, as taxpayer stresses (Br. 29–31), this Court in *New Colonial* observed that the transfer of the assets and liabilities from the old to the new corporation in exchange for the latter's stock "was voluntary and contractual, not by operation of law." But the transfer here involved was likewise voluntary and contractual, having been based upon an "Agreement" for statutory merger. (R. 15.) Indeed, the intercorporate reorganization transfer effected in this case was no different in substance from that which occurred in *New Colonial;* in both cases all the assets and liabilities of one corporation were voluntarily transferred to another in exchange for the stock of the transferee, which was distributed to the transferor's stockholders, and thereafter the transferor transacted no business and had no income. See 292 U. S. at 437–438. In any event, as is plain from a reading of the entire opinion in *New Colonial*, a net operating loss is not transferable from one corporation to another by any form of consensual arrangement, *i. e.* (*id.*, p. 439), "by deliberate elimination of the old company and substitution of the new one."

A like decision had been reached earlier by the First Circuit in *Athol Mfg. Co.* v. *Commissioner,* 54 F. 2d 230, in which one corporation had similarly taken over the assets, liabilities, and business of another in a reorganization. And since 1934, when *New Colonial* was decided, many cases have denied carry-over or carry-back on similar facts, and on the same rationale: that one corporation is not and cannot be the same taxpayer as another. *E. g., Brandon Corp.* v. *Commissioner,* 71 F. 2d 762 (C. A. 4th); *May Oil Burner Corp.* v. *Commissioner,* 71 F. 2d 644 (C. A. 4th); *Cem Securities Corp.* v. *Commissioner,* 72 F. 2d 295 (C. A. 4th); *Shreveport Producing & Refining Co.* v. *Commissioner,* 71 F. 2d 972 (C. A. 5th), certiorari denied, 293 U. S. 616; *Pennsylvania Co., Etc.* v. *Commissioner,* 75 F. 2d 719 (C. A. 3d); *Weber Flour Mills Co.* v. *Commissioner,* 82 F. 2d 764 (C. A. 10th); *Standard Paving Co.* v. *Commissioner,* 13 T. C. 425, affirmed, 190 F. 2d 330 (C. A. 10th), certiorari denied, 342 U. S. 860;[8] *Common-*

[8] In *Standard Paving* (which involved a claimed carry-back instead of carry-over) the Tenth Circuit declared that (p. 333) "A corporation being a separate legal entity, its net earnings, whether ascertained or not, belong to it," and went on to hold (pp. 333–334):

"To entitle a taxpayer to deductions in income tax liability, it must bring itself clearly within the statutory provisions. *White* v. *United States,* 305 U. S. 281, 292 * * *. This we think the taxpayer here has failed to do. Oklahoma Standard, an entity separate from its successor, ceased to exist upon the date of dissolution. It is a basic concept of taxation that the only person who can take a net operating loss deduction is the taxpayer who sustained the loss and therefore a successor corporation is not entitled to deduct the losses of its predecessor even

wealth Title Co. v. *Rothensies*, 124 F. Supp. 274 (E. D. Pa.); *Follansbee Steel Corp.* v. *United States*, 109 F. Supp. 635 (W. D. Pa.); *Donohue* v. *United States*, 112 F. Supp. 660 (E. D. Mo.); *Newmarket Manufacturing Co.* v. *United States*, 130 F. Supp. 706 (D. Mass.), reversed, 233 F. 2d 493 (C. A. 1st); *Trinco Industries* v. *Commissioner*, 22 T. C. 959; *California Casket Co.* v. *Commissioner*, 19 T. C. 32; *E. & J. Gallo Winery* v. *Commissioner*, decided April 17, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53, 131), reversed, 227 F. 2d 699 (C. A. 9th).

There is no need to join in taxpayer's discussion (Br. 10–14) of the effect of a merger or other type of corporate reorganization under the Missouri and Illinois laws. It suffices that the laws of those states do not purport to erase, or to deny recognition to, the separate prior existences of the transferor and transferee corporations, and that they do not purport to authorize a deduction by one of the corporations of net operating losses sustained by the other for purposes of computing their respective federal income tax liabilities.[9] Moreover, even if a state through its leg-

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though it had assumed all of the liabilities of the predecessor. [Citing *New Colonial Co.* and many other decisions.] * * * We think the rule applies conversely, which would prohibit Oklahoma Standard from deducting losses sustained by Delaware Standard."

[9] Even under state law the successor corporation in a statutory merger or consolidation is not the same entity, in all respects, as its predecessor or predecessors; otherwise the reorganization would have accomplished nothing. Indeed, it is only because the merger or consolidation will effect some desired change that it is conceived and carried out. As for state laws which provide in

islature or courts attempted to do so, the local law would not be controlling, since the question is manifestly one of federal law governed by the federal taxing statute, and it is clear from the scheme of the federal statute, as well as from the decisions of this Court, that every corporation is a separate unit for purposes of determining its federal income tax liability (including the availability of a net operating loss carry-over under Section 122). It is true that for some limited purposes the federal taxing statute treats a transferee corporation which is a party to a tax-free reorganization (including a merger) as standing in the shoes of a transferor (see, *e. g.*, Sections 113 (a) (7) and 311). It has also been held that, under state merger and consolidation laws which shift the obligations of the transferor corporations to the transferee corporation, the federal tax liabilities of the transferors are shifted in the same manner; and that the transferee, as substituted obligor, may petition for redetermination of deficiencies.[10]

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general terms that the successor corporation in a merger or consolidation shall succeed to the rights, privileges and obligations of the predecessor or predecessors, such provisions must, of course, be read as conferring only what it is within the power of the state to give; that is, rights, privileges and obligations created by the laws of that particular state. As Judge Learned Hand pointed out in his dissent in *Stanton Brewery* v. *Commissioner*, 176 F. 2d 573 (C. A. 2d), such laws cannot be read as creating credits or deduction rights under federal revenue laws, passing with corporate assets, like good will or trademarks.

[10] *Oswego Falls Corp.* v. *Commissioner*, 26 B. T. A. 60, affirmed, 71 F. 2d 673 (C. A. 2d); *Saenger* v. *Commissioner*, 38 B. T. A. 1295; *Bowman Hotel Corp.* v. *Commissioner*, 24 B. T. A. 1193; *Trahern Pump Co.* v. *Commissioner*, 27 B. T. A. 363; *Alaska Salmon Co.* v. *Commissioner*, 39 B. T. A. 455.

But these decisions, while they speak of the successor corporation as "the taxpayer" with respect to the tax liabilities of its predecessors, do not stand for the proposition that the former is to be treated as the same taxable entity as the latter for all purposes. To the contrary, they recognize that the successor corporation is to be so viewed solely for the purpose of enforcement or redetermination of the surviving tax liabilities. It hardly follows, as taxpayer apparently assumes (Br. 14–16), that Congress meant to treat the successor corporation and its predecessors as one and the same "taxpayer" for the purposes of applying the net operating loss carry-over privilege afforded by Section 122.[11] In *New Colonial*, this Court flatly held otherwise.

Certainly, a corporation which acqured a business by transfer from an individual stockholder would not be entitled to carry over and deduct from its own income an operating loss sustained in an earlier year by the stockholder, for the simple reason that the transferor stockholder and transferee corporation are separate taxable entities. Similarly, an estate which acquires a business from a decedent (by testamentary transfer or by operation of intestacy laws) clearly would not be entitled to carry over and deduct from its income an operating loss sustained in an earlier year by the decedent, since the decedent and his estate

[11] "It is well to remember that the concepts employed in construing one section of a statute are not necessarily pertinent when construing another with a distinguishable background." *Rohmer v. Commissioner*, 153 F. 2d 61, 65 (C. A. 2d), certiorari denied, 328 U. S. 862.

are likewise separate taxable entities. No valid reason appears, and none is suggested by taxpayer, for reaching an opposite result in the case of intercorporate transfers effected by way of a merger or other type of reorganization. In the latter situation, no less than in the former, the transferor and transferee are different taxable entities and consequently are not the same "taxpayer" within the meaning of the net operating loss deduction provisions.

3. *Taxpayer corporation is not the same taxable entity as its predecessors merely because it acquired the predecessors' assets by a merger rather than through some other type of reorganization.*

Relying chiefly upon *Stanton Brewery* v. *Commissioner*, 176 F. 2d 573 (C. A. 2d), and cases following it,[12] taxpayer takes the position that the doctrine of corporate entity does not apply in the case of a reorganization transfer which takes the form of a merger. It argues that, by virtue of the laws of the states under which the instant merger was effected, a transferee corporation resulting from the merger succeeds by operation of law to all of the rights and obligations of the merged transferor, including deduction rights created by Congress for federal income tax purposes; and that consequently the transferee corporation must be deemed the same "taxpayer" as the transferor within the meaning of the net operating loss provisions

[12] *E. & J. Gallo Winery* v. *Commissioner*, 227 F. 2d 699 (C. A. 9th); *Koppers Co.* v. *United States*, 134 F. Supp. 290 (C. Cls.); *Newmarket Manufacturing Co.* v. *United States*, 233 F. 2d 493 (C. A. 1st). Petitions for certiorari are pending in the *Koppers* and *Newmarket* cases, Nos. 215 and 216.

of the federal taxing statute, entitled to carry over and deduct from its own income a net operating loss sustained by the transferor corporation in a prior year. We respectfully submit that the *Stanton* case was incorrectly decided; that the strong dissenting opinion of Judge Learned Hand represents the correct view; that the Tax Court has properly declined to follow *Stanton*,[13] as have both courts below; and that, in any event, the *Stanton* case is distinguishable from this case.

Stanton dealt with the merger of an operating and a holding corporation, and it was held that the successor corporation could carry over and deduct an unused excess profits credit of the operating corporation. The majority of the court so held on the theory that, since the successor corporation became directly liable under the state (New York) law for outstanding debts of the transferor (merged) corporation, including tax indebtedness, it should be deemed to be the same "taxpayer" as the transferor for purposes of applying the carry-over provisions. It reasoned that the successor corporation was a "union of component corporations into an all-embracing whole which absorbs the rights and privileges, as well as the obligations, of its constituents" by operation of state

[13] *California Casket Co.* v. *Commissioner*, 19 T. C. 32; *Trinco Industries* v. *Commissioner*, 22 T. C. 959; *E. & J. Gallo Winery* v. *Commissioner*, decided April 17, 1953 (1953 P-H T. C. Memorandum Decisions, par. 53,131), reversed, 227 F. 2d 699 (C. A. 9th); *Standard Paving Co.* v. *Commissioner*, *supra*. See also the opinion of the District Court in the *Newmarket* case, *supra*, reported at 130 F. Supp. 706 (D. Mass.).

law (p. 575), and consequently was "'the taxpayer' now obligated to pay their taxes and entitled to their credits" under the federal taxing statute (p. 576).

The reasoning of the majority of the court in *Stanton* is vulnerable in at least three important respects. First, by treating the merged corporation and the corporation resulting from the merger as the same "taxpayer", the court disregarded the established rule that every corporation is a separate taxable entity for federal income tax purposes. *New Colonial Co.* v. *Helvering, supra; Moline Properties* v. *Commissioner, supra; National Carbide Corp.* v. *Commissioner, supra.* Secondly, by hinging the meaning of "the taxpayer", as used in Section 122 of the Internal Revenue Code, upon the nature and effect of a merger under state law, the majority disregarded the settled principle that the federal revenue laws should be interpreted "so as to give a uniform application to a nationwide scheme of taxation." *Burnet* v. *Harmel,* 287 U. S. 103, 110; *Lyeth* v. *Hoey,* 305 U. S. 188, 194; *United States* v. *Pelzer,* 312 U. S. 399, 402–403; *Helvering* v. *Stuart,* 317 U. S. 154, 161; *United States* v. *Gilbert Associates,* 345 U. S. 361, 364. "Congress establishes its own criteria and the state law may control only when the federal taxing act by express language or necessary implication makes its operation dependent upon state law." *Lyeth* v. *Hoey, supra,* p. 194. Nothing in the language of the carry-over provisions involved in the *Stanton* case, or of those involved in the present case, either expressly or by necessary implication, warrants the view that local law is to govern who is "the taxpayer" entitled to carry over

a federal tax credit or loss from one year to another.[14] Thirdly, there is no ground for the further assumption—upon which the majority opinion in *Stanton* also rests—that, because the transferee corporation in a merger becomes obligated by operation of law to pay existing tax debts of the transferor, it necessarily also becomes entitled to carry over and subtract from its own future taxable income any tax credits or deductions which belonged to the transferor.[15] Whether unused income tax credits or benefits belonging to the transferor pass to the transferee and are deductible from its future taxable income is purely a matter of legislative grace, and Congress has not

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[14] Many states do not permit mergers or consolidations at all, while others limit them to domestic corporations. See Schorr, *Taxable Dividends in Reorganization Cases*, New York University Institute on Federal Taxation, Seventh Annual (1948), pp. 507–509. Under taxpayer's interpretation of Section 122, the availability of the net operating loss privilege would vary from state to state, depending on whether a merger is permissible under the local law, and, if permissible, on whether the local law purports to treat tax deduction privileges created by Congress as assignable from one corporate taxpayer to another.

[15] 1939 Code Section 311 imposes upon a "transferee" of a taxpayer's property "liability, at law or in equity," for federal taxes owing by the taxpayer, to the extent of the value of the property received by the transferee. It affords an expeditious method for the collection of taxes whenever a taxpayer by transferring his assets leaves himself without funds to meet his tax liability, by providing a summary procedure for enforcing the transferee's liability at law or in equity. *Phillips* v. *Commissioner*, 283 U. S. 589; *Phillips-Jones Corp.* v. *Parmley*, 302 U. S. 233. The term "transferee" as used in Section 311 includes "the successor of a corporation, a party to a reorganization as defined in section 112" (Section 29.311–1 of Regulations 111); and Section 112 (g) defines a "reorganization" as including "a statutory merger or consolidation."

seen fit in the 1939 Code to extend such tax benefits to a taxpayer's transferee. *New Colonial Co.* v. *Helvering, supra.* As Judge Learned Hand stated in his *Stanton* dissent (p. 578):

> * * * I do not think that it is more consistent with any declared purpose that I can find, to extend the privilege of a "carry-over" to the taxpayer at bar. Indeed, as the decisions cited in my brothers' opinion show, privileges, closely akin in purpose to this, are ordinarily lost by transfers by one corporation to another; and the form of the transfer cannot be important. We have no warrant for supposing that Congress in general regards such credits as parts of a "universitas juris," passing, with the chattels, choses in action and the rest, like good-will or trade-marks.

In any event, the *Stanton* case is distinguishable on its facts. There, the merger involved a single operating corporation and a parent holding corporation. The business carried on by the transferee corporation after the merger was substantially the same as that which had theretofore been carried on by the merged operating corporation, and even without the merger the latter would have been entitled to the claimed deduction—a crucial feature, in the opinion of the majority, in view of its holding (p. 577) that Congress intended the carry-over provisions to apply "to what is essentially a continuing enterprise". Here, sixteen separate operating corporations conducting sixteen separate stores were merged into a seventeenth corporation, so that the business there-

after carried on by the transferee corporation was substantially different. The taxpayer here is seeking to deduct pre-merger losses of three of the stores from the post-merger income of the other stores. Moreover, these three stores continued to operate at a loss after the merger; had the merger never occurred the three taxpayers who sustained the losses would not have been entitled to the carry-over which the transferee-taxpayer here seeks. Thus taxpayer is not asserting a tax benefit which would have existed in the absence of the merger, as was the taxpayer in *Stanton*; it is seeking to create one solely by reason of the merger.

The other cases involving application of the net operating loss provisions (*E. & J. Gallo Winery* v. *Commissioner*, 227 F. 2d 699 (C. A. 9th); *Koppers Co.* v. *United States*, 134 F. Supp. 290 (C. Cls.); *Newmarket Manufacturing Co.* v. *United States*, 233 F. 2d 493 (C. A. 1st)), upon which taxpayer relies, follow the majority opinion in *Stanton*. Like *Stanton*, they proceed upon a combination of two theories: (1) a corporation resulting from a merger is the same corporate entity as the merged corporation; (2) the resulting corporation continued to carry on the same business enterprise as the merged corporation. Insofar as they hold that a transferee corporation in a merger is the same taxable entity as the transferor for purposes of applying Section 122, they derogate from this Court's *New Colonial* decision and rest upon a meaningless distinction between merger and non-merger transfers. As this Court made clear in *New Colonial*, the carry-over privilege does not inure to the benefit

of a reorganization transferee for the simple reason that it is not the same taxable entity as the transferor; and that reason applies equally whether the reorganization is of the merger or non-merger type.[16] And insofar as the cases rest upon the continuing enterprise theory, they are, of course, grounded upon a feature not present here, since taxpayer took over the business of sixteen different operating corporations and not just the business of the corporations whose losses it seeks to carry over and deduct.

The court below properly observed, therefore, that the *Stanton* and *Gallo* cases "stand on the same footing" and are "not persuasive." (R. 58.) The same observation applies to *Koppers,* where the merged corporations had been filing consolidated returns. As for the *Newmarket* case, which also involved a continuing enterprise, it is to be noted that the court there did not disagree with the decision below; on the contrary,

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[16] It is true, as noted in the *Stanton* majority opinion, that application of the corporate entity doctrine may, in some instances, render the availability of the net operating loss deduction dependent upon which of two or more corporations survives a merger or other reorganization. But the corporate entity doctrine, albeit a technical one based upon a fictional distinction between a corporation and its stockholders, plays a vital role in the federal taxing scheme as in other fields, and must be strictly and uniformly applied irrespective of whether it is the taxpayer or the Government whose interests are adversely affected. *Moline Properties* v. *Commissioner, supra; National Carbide Corp.* v. *Commissioner, supra; New Colonial Co.* v. *Helvering, supra.* Besides, a taxpayer is not immune from tax liability on a taxable transaction merely because it might have chosen a non-taxable (or less taxable) method of achieving the same result; tax consequences flow from what the taxpayer does, not from what it might have done. *Founders General Co.* v. *Hoey,* 300 U. S. 268, 275.

it expressly distinguished *Newmarket* from the instant case, and ruled (p. 499) in the taxpayer's favor "without intending to go beyond the facts of the case at bar."

Equally misplaced is taxpayer's reliance upon *Helvering* v. *Metro. Edison Co.*, 306 U. S. 522, and cases which led up to that decision. Those cases involved a question far removed from that here presented, namely, whether a corporation resulting from a merger may deduct unamortized discount on bonds issued by the predecessor and assumed by the successor. Nothing in those decisions may be fairly construed as undermining the corporate entity doctrine enunciated in the *New Colonial* case and implemented in the *Moline* and *National Carbide* cases, or as supporting a distinction between merger and non-merger reorganizations for purposes of determining the right of one corporation to carry over and deduct a net operating loss sustained by another.

Prior to *Metro. Edison*, there had been four decisions allowing a successor corporation to deduct unamortized bond discount and expense. In all of these, the courts viewed the bond indebtedness as having been transferred from the predecessor by operation of law as a result of statutory merger or consolidation. *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. 2d 6[illegible] (C. A. 4th); *New York Cent. R. Co.* v. *Commissioner*, [illegible] 2d 247 (C. A. 2d), certiorari denied, 296 U. S. 655; *American Gas & Elec. Co.* v. *Commissioner*, 85 F. 2d 527 (C. A. 2d); and *American Gas & Electric Co.* v. *United States*, 17 F. Supp. 151 (C. Cls.). In *Metro. Edison*, this Court also

found that taxpayer had consummated a merger and it similarly concluded, in harmony with the earlier decisions of the lower federal courts, that the bond indebtedness had been transferred by operation of law. From this, it followed logically that the deduction was permissible. For since there was no consideration for the passing of the obligation to the transferee corporation, the loss was one which would ultimately be sustained *by the transferee*. In *New York Cent. R. Co.* v. *Commissioner*, the Second Circuit had stated the rationale as follows (79 F. 2d at 249):

> The consolidated corporation does not succeed to the rights and liabilities of the constituent companies as a purchaser but as a successor by operation of law. * * * The assets of the consolidated corporation have the same cost basis as they had when held by the old companies, and are subject to the lien of the bond issues. *Hence the consolidated corporation will suffer a loss when it pays the bonds at par* * * *. As already stated, the subject of amortization is the difference between the cash realized on the bonds and their par value. This difference the consolidated corporation will pay when the bonds mature, and this expenditure it should be allowed to anticipate by yearly amortization during the life of the bonds in order more clearly to reflect its income.
>
> The Commissioner argues that allowable deductions are personal to the taxpayer and cannot be transferred to or used by another. *But the cases which announce this doctrine deal with losses sustained by a predecessor and sought to be deducted by a successor.* [Citing *New Colonial* and companion decisions.] * * * *no loss was sus-*

tained by the issuing corporations in selling their bonds at a discount; the loss will be sustained by the consolidated corporation when the bonds mature and are paid. Hence the deductions here in question are by way of anticipation of the taxpayer's own loss and should have been allowed. [Emphasis added.]

Thus, where bond indebtedness is transferred by operation of law, rather than for a consideration, the successor corporation *itself* sustains the unamortized bond discount loss *after* the reorganization, and hence can deduct the loss *as its own*.[17] It is in this context

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[17] The reason for distinguishing between a gratuitous transfer by operation of law and a contractual transfer for a consideration was stated in *Jones* v. *Noble Drilling Co.*, 135 F. 2d 721, 725 (C. A. 10th):

"If the corporate taxpayer acquired the assets of the subsidiary by contract for a stipulated consideration, it would be a reasonable assumption that, in fixing the amount of consideration to be paid, it would give regard to and make due allowance for the bond discount to be assumed and paid by it; whereas, if the obligations were assumed by operation of law, it would have no opportunity so to do."

Put another way in *Athol Mfg. Co.* v. *Commissioner*, *supra*, 54 F. 2d at 231, where the successor corporation contractually assumes the obligations of the predecessor, subsequent payments on the obligations cannot be deductible losses or expenses of the successor, because they are in reality "part of the consideration for the purchase of the assets of the old company; * * * part of the cost to the petitioner of those assets and constituted a capital, not a business, expense." Where the transfer is by operation of law, however, the losses and expenses are sustained *by* the successor *after* the reorganization, and hence are deductible. *New York Cent. R. Co.* v. *Commissioner*, *supra*. As the Court of Claims stated in *American Gas & Electric Co.* v. *United States*, *supra*, 17 F. Supp. at 159:

"The right to claim a deduction on account of having redeemed the bonds at a price above par did not come into existence until

that the Commissioner conceded in *Metro. Edison,* as noted in this Court's opinion (p. 526), that in the case of a merger or consolidation, as contrasted with a sale, "the identity of the corporation issuing the bonds continues in the successor and the latter becomes liable for the debts of the former by operation of law", and that in such situations the successor may deduct losses and expenses attributable to the assumed bond indebtedness. And it is in the same sense, we believe, that this Court concluded in *Metro. Edison* (p. 529):

> We are of opinion that *a transfer without valuable consideration,* with the intent that the transferor shall, as the statute provides, cease to exist, made in accordance with the statute, has all the elements of a merger and comes within the principle that the corporate personality of the transferor is drowned in that of the transferee. It results that the continuing corporation may deduct unamortized bond discount and expense in respect of the obligations of the transferring affiliate. [Emphasis added.]

In short, the bond discount cases upon which taxpayer relies stand merely for the proposition that where the bond indebtedness is transferred "without valuable consideration", so that there has been no adjustment of a purchase price to reflect prospective losses and expenses attributable to the bonds, the successor corporation is to be treated as if it were the issuer of the bonds, and accordingly may deduct the

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the bonds were so redeemed and, as we think, belonged to the corporation making the payment. Clearly it was this corporation that sustained the loss."

future losses and expenses as they are sustained, *after* the merger.

The problem here is not comparable to that presented in the cases involving deductibility of unamortized bond discount, nor do the decisions in those cases depart from the rule of the *New Colonial* case. Taxpayer here is not attempting to deduct a post-merger expense or loss *of its own* arising out of an assumption of a predecessor's bond obligations, as were the taxpayers in those cases. Rather, it is attempting to carry over and deduct pre-merger net operating *losses of three of its predecessors.* As this Court held in *New Colonial,* the taxing statute accords the carry-over privilege only to "the taxpayer" who sustained the loss, not to a transferee. Under that decision the privilege is not assignable from one taxpayer to another, and this is so regardless of whether the purported assignment is made gratuitously, by way of a merger or other corporate reorganization, or for a consideration. Significantly, there is nothing in the opinion of this Court in *Metro. Edison* which even remotely suggests that the Court was departing from its holding in *New Colonial;* indeed, in view of the absence of reference to *New Colonial,* it is apparent that this Court did not consider the issues in the two cases to be analagous.

Taxpayer's failure to distinguish between a post-merger expense of the transferee corporation itself (involved in *Metro. Edison*) and a pre-merger net operating loss of the transferor corporation (involved in *New Colonial* and this case) likewise accounts for its

claim (Br. 7, 21–22) that the Government's position here is inconsistent with an informal administrative ruling contained in P. S. 62 (May 5, 1950, 1950 C. C. H., par. 6118). That ruling was addressed to the question of deductibility of the unamortized portion of an amount paid by an employer corporation under a pension plan to fund the cost of past service credits of the employee-beneficiaries, under the provisions of Section 23 (p) (1) (A) (iii) and (iv) of the Internal Revenue Code of 1939. After the cost had been partially amortized, the employer corporation, pursuant to a merger, transferred its assets and liabilities to another corporation, which assumed the obligations under the pension plan and consequently obligated itself to pay the pensions as they became due. In P. S. 62, the Deputy Commissioner took the view that the problem was analogous to that presented in *Metro. Edison,* rather than to the question in *New Colonial,* and accordingly instructed Internal Revenue agents to allow the transferee corporation to deduct the unamortized cost of the pension plan assumed by it to the same extent that the transferor would have been entitled to do so. Surely, this ruling furnishes no basis for taxpayer's charge of inconsistency.[18] In cases involving the question whether net operating

[18] Even if it were assumed that the view expressed in P. S. 62 is not fully consistent with the contention urged here, that would scarcely be a decisive consideration, particularly since the earlier view did not have the status of a formal Treasury ruling nor reflect an established course of administrative construction. See *Helvering* v. *Southwest Corp.*, 315 U. S. 194, 201, fn. 2; *Helvering* v. *Reynolds*, 313 U. S. 428; *Helvering* v. *Wilshire Oil Co.*, 308 U. S. 90.

losses may cross the line of a statutory merger, the Government has consistently urged that they may not and that *New Colonial* controls.[19]

B. EVEN IF REGARDED AS THE SAME TAXABLE ENTITY AS ITS PREDECESSORS, TAXPAYER IS NOT ENTITLED TO THE CLAIMED OPERATING LOSS DEDUCTION SINCE ITS BUSINESS WAS NOT THE SAME

If, as we submit, taxpayer corporation is not the same "taxpayer" as its extinct predecessors, within the meaning of Section 122, then the decision below is entitled to affirmance on that ground alone, and there is no necessity to inquire whether taxpayer has also met the so-called continuity of enterprise test, *i. e.*, whether the income for the taxable year against which it seeks to offset the predecessors' operating losses in prior years was derived from a continuation of the same business as that which produced the losses. However, should this Court hold that taxpayer is to be deemed the same taxable entity as its predecessors, then we submit that the decision below is nevertheless correct on the alternative ground—also relied upon by the court below—that taxpayer's business was substantially different from that of the predecessors.

As is plain from the legislative history of the net operating loss provisions, discussed above (pp. 13–15), the loss carry-over privilege was designed to permit a taxpayer whose business income fluctuated widely

[19] Indeed, the Commissioner has taken the position, albeit unsuccessfully, that even the *same* corporate taxpayer is not entitled to carry over a net operating loss, where the business which gave rise to the loss was not substantially the same as that which produced the income from which the taxpayer sought to deduct the loss. *Alprosa Watch Corp.* v. *Commissioner*, 11 T. C. 240.

from year to year to average the income over a period of years. In substance, the privilege constitutes an exception to the fundamental rule that taxable income is to be computed on an annual accounting basis. It manifestly was never intended to permit the averaging of business incomes of corporations which conduct different businesses. Compare Section 382 (a) (1) (C) of the Internal Revenue Code of 1954, which precludes a carry-over even by the same corporation unless, among other things, the corporation continues to carry on "substantially the same" business as before.

This underlying purpose of the net operating loss carry-over privilege has indeed received recognition in the very cases upon which taxpayer relies. Thus in *Stanton,* upon which it chiefly relies, the court in reaching its decision stressed (176 F. 2d at 577) that the transferor and transferee corporations in the merger carried on "essentially a continuing enterprise, entitled to all their [net operating loss provisions] benefits in ameliorating otherwise harsh tax consequences of fluctuating profits or expanding business." And in *Newmarket,* upon which taxpayer also strongly relies, the court expressly distinguished that case from this one on the ground (233 F. 2d at 497) that there the business and stockholders of the transferor and transferee corporations were the same—"one single business"—whereas in this case there was a merger of "several businesses." Thus, the very considerations which impelled the courts in *Stanton* and *Newmarket*

to allow the claimed deduction—continuity of the enterprise—compel an opposite result in this case by reason of the absence of that feature.[20]

The taxpayer corporation which here claims the right to carry over a previous year's operating loss is not only a different taxpayer from the one which sustained the loss; the income against which it seeks to offset the loss was not even derived from the same business which gave rise to the loss. Here, the assets and liabilities of sixteen separate corporations, each conducting a retail store at a different location and each having a separate profit-loss history, were transferred to another corporation (taxpayer) pursuant to a merger. The business which was thereafter conducted by the transferee corporation—a combination of all of the stores—was substantially different from that previously conducted, when each store was separately owned and operated. Cf. *Interstate Transit Lines* v. *Commissioner,* 319 U. S. 590. The segregated pre-merger business operations which produced the losses in question had no post-merger counterpart; conversely, the integrated post-merger operations which produced the income against which taxpayer would apply the losses had no pre-merger counterpart. While the several

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[20] The *Koppers* case likewise presented a situation in which the corporation resulting from the merger carried on essentially the same enterprise as before, since the merged corporations had been filing consolidated tax returns. As for *Gallo*, as the court below observed (R. 57–58), the opinion in that case does not disclose "whether or not there was involved a continuing enterprise," and "[a]pparently the *Gallo* and *Stanton* cases stand on the same footing."

corporations were converted into a single entity by virtue of the merger, that entity was neither the same corporate entity nor the same business entity which experienced the pre-merger losses. Only by reconstructing a hypothetical consolidated profit and loss statement of the merged corporations for the pre-merger years and comparing the result with the income for the post-merger year here involved, and by superimposing the further hypothesis that taxpayer and the merged corporations were one and the same taxable entity, can it be said that taxpayer is entitled to the claimed carry-over privilege. To allow the post-merger income of the consolidated enterprise to be offset by pre-merger losses of some of the merged corporations would extend the relief granted by the carry-over provisions far beyond that contemplated by Congress. It would enable taxpayer to reduce its own average business income, which Congress meant to tax, by losses sustained by other taxpayers in other businesses.

Furthermore, to allow the deduction in controversy would produce the anomalous result that losses which the transferor (merged) corporations themselves could not have carried over in the absence of the merger may be carried over by the transferee (taxpayer) corporation solely by reason of the merger. The losses in question could not have been carried over by the merged corporations, even if their separate existences had not been terminated by the merger, since the stores which they respectively operated admittedly continued to sustain losses after the merger and during the tax-

able year here involved. (R. 17.) Thus, taxpayer is not asserting a right to a net operating loss deduction which, but for the merger, would have been available to the transferor corporations that sustained the losses. Rather it is seeking, solely by virtue of the merger, to obtain a deduction unavailable to the transferor corporations themselves. Surely, the merger did not in and of itself serve to create a Section 122 deduction where none existed before. That section was designed to place taxpayers whose business earnings fluctuated from year to year on a tax parity with those having stable annual earnings; it was never intended to accord them an advantage over other taxpayers. Instead of achieving the objective at which Section 122 was aimed, allowance of the deduction in controversy would bestow upon taxpayer a tax windfall.

To subscribe to taxpayer's interpretation of Section 122 would sanction abuse of the relief intended. It would extend the benefits of that section to a corporation which absorbs another corporation with a history of operating losses, with a view to deducting the losses from its own future income. In effect, it would lend judicial approval to the exploitation, for bargaining purposes, of the tax benefits afforded by the net operating loss carry-over provisions.[21] The District Court

[21] The limitation provisions in Sections 381 and 382 of the 1954 Code, relating to net operating loss carry-overs by successor corporations in mergers or other tax-free reorganization, were designed in part to prevent "trafficking in corporations with operating loss carryovers, the tax benefits of which are exploited by persons other than those who incurred the loss." H. Rep. No. 1337, *supra*, pp. 41–42 (3 U. S. C. Cong. & Adm. News (1954), 4017, 4067). See also S. Rep. No. 1622, *supra*, pp. 52–53 (3

had "no doubt" that, whatever other motive taxpayer corporation may have had in acquiring the assets of the three corporations whose stores had sustained operating losses, "use of their tax credits was one."[22] (R. 41.)

Had the loss stores been owned and operated by taxpayer's stockholders and then transferred to taxpayer corporation, the latter unquestionably could not avail itself of the carry-over privilege. No reason appears, nor is any offered by taxpayer, for reaching a different tax result merely because the transferors were corporations rather than individuals. In the one case, as

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U. S. C. Cong. & Adm. News (1954) 4621, 4683–4); H. Conference Rep. 2543, *supra*, pp. 39–40 (3 U. S. C. Cong. & Adm. News (1954) 5280, 5298–5300).

[22] Whether the claimed loss deduction would in any event be barred by Section 129 of the 1939 Code, as added by Section 128 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21, even if it qualified for deduction under Section 122, is of academic importance in this case in the absence of a finding that tax avoidance was the principal purpose of the transfer. Section 129 provides in substance that where any person acquires control of a corporation, or any corporation acquires the property of another corporation (other than one controlled by the same interests) in a tax-free exchange, and the "principal purpose" of the acquisition is tax avoidance through the benefit of a deduction or credit, then the deduction or credit shall not be allowed. Its provisions do not, as taxpayer implies (Br. 33), enlarge the category of allowable deductions, but were intended merely to supplement and extend established safeguards against tax avoidance schemes. H. Rep. No. 871, 78th Cong., 1st Sess., pp. 24, 49–50 (1944 Cum. Bull. 901, 938); S. Rep. No. 627, 78th Cong., 1st Sess., pp. 26, 58–61 (1944 Cum. Bull. 973, 1016–1017). Accordingly, while Section 129 might preclude deduction of a net operating loss which otherwise qualified for deduction under Section 122, it obviously cannot serve conversely to authorize deduction of a loss not otherwise allowable under Section 122.

in the other, the transferors and transferee are separate business and taxable entities. Having chosen for reasons of their own to discard the multiple corporate form as a mode for conducting business, and thereafter to carry on as a single taxable entity, the parties cannot now escape the tax "disadvantage" of that choice. *New Colonial Co.* v. *Helvering, supra,* 292 U. S. at 441. See also *Woolford Realty Co.* v. *Rose,* 286 U. S. 319; *Planters Oil Co.* v. *Hopkins,* 286 U. S. 332; *Trinco Industries* v. *Commissioner, supra.*

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted.

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OCTOBER 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * *

(s) [As added by Section 211, Revenue Act of 1939, c. 247, 53 Stat. 862] *Net Operating Loss Deduction.*—For any taxable year beginning after December 31, 1939, the net operating loss deduction computed under section 122.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 23.)

SEC. 122 [As added by Section 211, Revenue Act of 1939, supra]. NET OPERATING LOSS DEDUCTION.

(a) [As amended by Section 105 (e) (3) (A). Revenue Act of 1942, c. 619, 56 Stat. 798] *Definition of Net Operating Loss.*—As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) [As amended by Section 215, Revenue Act of 1950, c. 994, 64 Stat. 906] *Amount of Carry-Back and Carry-Over.*—

(1) *Net operating loss carry-back.*—

(A) *Loss for Taxable Year Beginning Before 1950.*—If for any taxable year beginning after December 31, 1941, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss car-

ry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year * * *.

* * * * *

(2) *Net operating loss carry-over.*—

* * * * *

(C) [As added by Section 330, Revenue Act of 1951, c. 521, 65 Stat. 452] *Loss for Taxable Year Beginning After December 31, 1947, and Before January 1, 1950.*—If for any taxable year beginning after December 31, 1947, and before January 1, 1950, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the three succeeding taxable years, except that the carry-over in the case of each such succeeding taxable year (other than the first succeeding taxable year) shall be the excess, if any, of the amount of such net operating loss over the sum of the net income for each of the intervening years * * *.

* * * * *

(c) [As amended by Sections 105 (e) (3) (B) and 153 (b) of the Revenue Act of 1942, *supra*, and Section 121 (g) (2) of the Revenue Act of 1950, *supra*] *Amount of Net Operating Loss Deduction.*—The amount of the net operating loss deduction shall be the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year reduced by the amount, if any, by which the net income (computed with the exceptions and limitations provided in subsection (d) (1), (2), (3), and (4)) exceeds, in the case of a taxpayer other than a corporation, the net income (computed without such deduction), or, in the case of a corporation, the normal-tax net income

(computed without such deduction and without the credits provided in sections 26 (h) and (i));

* * * * *

(26 U. S. C. 1952 ed., Sec. 122.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.122–1. *Net Operating Loss Deduction*—(a) *General.* (1) Section 122 provides the rules for the computation of the net operating loss deduction allowed by section 23 (s). The net operating loss deduction is the aggregate of the net operating loss carry-overs and carry-backs to the taxable year, reduced by certain adjustments to prevent the deduction of losses absorbed by income not taxed.

* * * * *

(b) [As amended by T. D. 5963, 1953–1 Cum. Bull. 197] *Steps in computation of net operating loss deduction.* There are three steps in the ascertainment of the net operating loss deduction. The first step is the computation of the net operating loss, if any, for any preceding or succeeding taxable year from which a net operating loss may be carried forward or carried back to the current taxable year. The second is the computation of the net operating loss carry-overs to the taxable year from such preceding taxable years and the computation of the net operating loss carry-backs to the taxable year from such succeeding taxable years. The third is the conversion of the aggregate of such net operating loss carry-overs and carry-backs into the net operating loss deduction.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 64

LIBSON SHOPS, INC., *Petitioner,*

v.

GUSTAVE F. KOEHLER, District Director of Internal Revenue, *Respondent.*

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

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INDEX

	Page
Statement	5
Summary of Argument	7
Argument	10
I. If a Business Has Merely Changed Its Corporate Domicile Through a Statutory Merger, Losses Sustained After the Merger May Be Carried Back Against Profits Earned Before the Merger	11
II. If Corporations Are Combined Through a Statutory Merger, Losses of a Component Corporation Before the Merger May Be Carried Over Against Profits of the Resulting Corporation After the Merger	31
Conclusion	55
Appendix	56

CITATIONS

CASES:

A.B. & Container Corp., 14 T.C. 842	48
Adrian & James, Inc., 4 T.C. 708	35
Alaska Salmon Co., 39 B.T.A. 455	33, 34
Alprosa Watch Corp., 11 T.C. 240	48
American Gas & Elec. Co. v. Commissioner, 85 F. 2d 527	23, 24, 36
American Gas & Electric Co. v. United States, 17 F. Supp. 151	23, 24, 36
Aspinook Corp. v. Commissioner of Corporations & Taxation, 326 Mass. 327, 94 N.E. 2d 366	14, 45
Athol Mfg. Co. v. Commissioner, 54 F. 2d 230	24
Bailey v. Railroad Company, 22 Wall. 604	34
Boehm v. Commissioner, 326 U.S. 287	27
Bond Crown & Cork Co., 19 T.C. 73	33
Bowman Hotel Corp., 24 B.T.A. 1193	32, 33, 34
Brooklyn Nat. Corp. v. Commissioner, 157 F. 2d 450, cert. denied, 329 U.S. 733	54
Burk-Waggoner Assn. v. Hopkins, 269 U.S. 110	42

Page

Burnet v. Sanford & Brooks Co., 282 U.S. 359 10
California Casket Co., 19 T.C. 32 41
Channing v. Hassett, 200 F. 2d 514 46
Commissioner v. Estate of Bedford, 325 U.S. 283 .. 37
Commissioner v. Korell, 339 U.S. 619 .....46, 53
Commissioner v. Oswego Falls Corp., 71 F. 2d 673 33, 34
Commissioner v. Wheeler, 324 U.S. 542 .....27, 50
Commonwealth Title Co. v. Rothensies, 124 F. Supp. 274 40
Connecticut Electric Service Co., 35 B.T.A. 444 ..23, 36
Crane v. Commissioner, 331 U.S. 1 37
Dartmouth College v. Woodward, 4 Wheat. 518 13
Donohue v. United States, 112 F. Supp. 660 28
Early v. Southgate Corp., 136 F. 2d 217 36
Falstaff Brewing Corp., P.-H. B.T.A. Memo. Dec. ¶ 39,371 33
Follansbee Steel Corp. v. United States, 109 F. Supp. 635 28
E. & J. Gallo Winery v. Commissioner, 227 F. 2d 699 23, 40, 53
E. & J. Gallo Winery, 12 T.C.M. 414, *rev'd*, 227 F. 2d 699 41
Gramm Trailer Corp., 26 T.C. No. 84 .....28, 41
Great Northern Ry. Co. v. United States, 315 U.S. 262 39
Gregory v. Helvering, 293 U.S. 465 51
Griffiths v. Commissioner, 308 U.S. 355 10
Guaranty Trust Co. v. N.Y. & A.C. Ry. Co., 253 N.Y. 190, 170 N.E. 887 13
Haggar Co. v. Helvering, 308 U.S. 389 .....10, 50
Helvering v. Clifford, 309 U.S. 331 13
Helvering v. Fuller, 310 U.S. 69 42
Helvering v. Hallock, 309 U.S. 106 .....39, 51
Helvering v. Horst, 311 U.S. 112 51
Helvering v. Metropolitan Edison Co., 306 U.S. 522 8, 21, 22, 23, 24, 25, 26, 36, 42
Helvering v. New York Trust Co., 292 U.S. 455 50
Helvering v. Oregon Insurance Co., 311 U.S. 267 ... 27
Helvering v. Reynolds Co., 306 U.S. 110 27
Helvering v. Stuart, 317 U.S. 154 42
Helvering v. Union Pacific Co., 293 U.S. 282 54
Helvering v. Winmill, 305 U.S. 79 27

Page

Helvering v. Wood, 309 U.S. 344 48
Henneford v. Silas Mason Co., 300 U.S. 577 12
Higgins v. Smith, 308 U.S. 473 ..... 50, 51
Hopkins Savings Assn. v. Cleary, 296 U.S. 315 41
Hulburd v. Commissioner, 296 U.S. 300 42
Illinois Power & Light Corp., 33 B.T.A. 1189 ..... 23, 36
International Mining Corp., P.-H. B.T.A. Memo. Dec. ¶ 41,146 33
Kingston Dry Dock Co. v. Lake Champlain Transp. Co., 31 F. 2d 265 13
Koppers Coal Co., 6 T.C. 1209 ..... 35, 45
Koppers Company v. United States, 134 F. Supp. 290 ..... 23, 33, 37, 38, 39, 40, 53
Kordel v. United States, 335 U.S. 345 53
Lewyt Corp. v. Commissioner, 349 U.S. 237 ..... 10, 54
Logan v. Davis, 233 U.S. 613 39
Lyeth v. Hoey, 305 U.S. 188 41
Lykes v. United States, 343 U.S. 118 53
Magruder v. Supplee, 316 U.S. 394 ..... 35, 42
Manning v. Seeley Tube & Box Co., 338 U.S. 561 11
Metropolitan Bank v. Claggett, 141 U.S. 520 16
Mary Miller, 22 T.C. 293 29
Minnesota Tea Co. v. Helvering, 302 U.S. 609 51
Moldit, Inc. v. Jarecki, 53-2 U.S.T.C. ¶ 9551, appeal dismissed pursuant to stipulation, 7th Cir., July 26, 1954 40
Morgan v. Commissioner, 309 U.S. 78 42
Morrisdale Coal Mining Co., 19 T.C. 208 38
New Colonial Co. v. Helvering, 292 U.S. 435 ..... 7, 8, 17, 20, 21, 22, 24, 25, 26, 28, 29, 39, 41
New York Central R. Co. v. Commissioner, 79 F. 2d 247, cert. denied, 296 U.S. 653 36
Northern Ohio Railway Co., 6 T.C.M. 1230 33
Northway Securities Co., 23 B.T.A. 532 48
Oswego Falls Corp., 26 B.T.A. 60, aff'd, 71 F. 2d 673 ..... 21, 45
Pearce v. Commissioner, 315 U.S. 543 30
Phillips v. Lyman H. Howe Films Co., 33 F. 2d 891 33
Portland Oil Co. v. Commissioner, 109 F. 2d 479, cert. denied, 310 U.S. 650 30
Raybestos-Manhattan Co. v. United States, 296 U.S. 60 51
Rodney, Inc. v. Commissioner, 145 F. 2d 692 36

	Page
Estate of Rogers v. Commissioner, 320 U.S. 410	41, 44
Rosenman v. United States, 323 U.S. 658	30, 55
A. D. Saenger, 38 B.T.A. 1295	36, 45
Skaneateles Paper Co., 29 B.T.A. 150, aff'd on another issue, 71 F. 2d 584	33, 34
Standard Paving Co. v. Commissioner, 190 F. 2d 330	28
Standard Paving Co. v. Commissioner, 342 U.S. 860	28
Stanton Brewery v. Commissioner, 176 F. 2d 573	11, 23, 28, 31, 32, 34, 36, 39, 40, 41, 44, 45, 51, 53
Trahern Pump Co., 27 B.T.A. 363	33
Turner-Farber-Love Co. v. Helvering, 68 F. 2d 416	23, 24, 25
United States v. Brown, 333 U.S. 18	53
United States v. Loan & Bldg. Co., 278 U.S. 55	42
United States v. Newmarket Manufacturing Company, No. 216, October 1956 Term	2, 3, 5, 7, 10, 11, 14, 18
United States v. Northwestern Nat. Bank & T. Co. of Minneapolis, 137 F. 2d 761	36
United States v. Olympic Radio & Television, 349 U.S. 232	11, 37
United States v. Oswego Falls Corp., 113 F. 2d 322	33, 34
United States v. Pelzer, 312 U.S. 399	41
United States v. Seattle Bank, 321 U.S. 583	21
United States v. Sullivan, 332 U.S. 689	53
Universal Camera Corp. v. Labor Board, 340 U.S. 474	54
Eleanor H. Vendig, 22 T.C. 1127	28
Van Vranken v. Helvering, 115 F. 2d 709, cert. denied, 313 U.S. 585	54
Wage, Inc., 19 T.C. 249	48
Western Maryland Ry. Co. v. Commissioner, 33 F. 2d 695	36
White v. Winchester Club, 315 U.S. 32	39
George Whittell & Co., 34 B.T.A. 1070	18
Wisconsin v. J. C. Penney Co., 311 U.S. 435	13

STATUTES:

Act of 1938, § 406(a)(1), 52 Stat. 561	35
Act of July 15, 1947, c. 249, 61 Stat. 324, 26 U.S.C.A. § 122	51
Delaware Revenue Code, c. 65, §§ 59, 60	14

Page

Internal Revenue Code of 1939:

§ 23(b) 36
§ 23(p)(1)(A) 26
§ 23(s) 2, 10, 26
§ 41 30
§ 46 30
§ 52 ..... 15, 17
§ 112(b)(6) 27
§ 112(g)(1)(F) 18
§ 113(a)(20) 52
§ 122 ..... 2, 7, 8, 9, 10, 11, 12, 30, 32, 37, 39, 45, 48, 50, 54
§ 122(b)(1)(B) 11
§ 129 ..... 38, 46, 47, 49, 55
§ 272(a)(1) 33
§ 276(b) 33
§ 505(a)(1) 35
§ 710(c) 39
§ 740 40
§ 742 40
§ 3797 ..... 32, 37
§ 3797(a)(1) 32
§ 3797(a)(14) 8, 32

Internal Revenue Code of 1954:

§ 164 35
§ 269 49
§ 368(a)(1)(F) 18, 19
§ 381 ..... 7, 17, 18, 19, 20, 26, 48, 49, 50
§ 382 49
§ 441 30
§ 442 30
§ 446 30

Massachusetts Ann. Laws c. 156:

§ 46D 14
§ 46D(b)(2) 14

Pub. L. No. 396, 70 Stat. 7, 84th Cong., 2d Sess. 27
Revenue Act of 1938, § 406(a)(1), 52 Stat. 561 35
Revenue Act of 1943, § 128, c. 63, 58 Stat. 21 46

MISCELLANEOUS: Page

Conf. Rep. No. 2543, 83d Cong., 2d Sess. 40 49
C.S.T. 13, 1945 CUM. Bull. 430 17
Dewey, The Historic Background of Corporate Legal Personality, 35 Yale L. J. 655 13
Frankfurter, Some Reflections on the Reading of Statutes, 47 Col. L. Rev. 527 54
G.C.M. 7310, IX-1, Cum. Bull. 237 ..... 33, 34, 54
G.C.M. 11387, XII-1 Cum. Bull. 427 17
G.C.M. 24423, 1945 Cum. Bull. 145 15
Gray, The Nature and Sources of the Law 50-57 ... 13
Griswold, Note, 56 Harv. L. Rev. 1142 53
Henderson, The Position of Foreign Corporations in American Constitutional Law 165-168 13
H. R. Rep. No. 624, 80th Cong., 1st Sess. 6 ..... 51, 52
H. R. Rep. No. 855, 76th Cong., 1st Sess. 9, 10 29
H. R. Rep. No. 881, 78th Cong., 1st Sess. 24, 49 47
H. R. Rep. No. 1337, 83d Cong., 2d Sess. 41, A 135 ..... 19, 20, 48
H. R. Rep. No. 1594, 84th Cong., 1st Sess. 2 27
I. T. 2005, III-1 Cum. Bull. 299 17
I. T. 3871, 1947-2 Cum. Bull. 62 15
Mertens, Law of Federal Income Taxation, Code Commentary § 381(b):2 19
P. S. No. 62, 5 C.C.H. Fed. Tax Rep. § 6118 ..... 25, 26
Rev. Rul. 54-193, 1954-1 Cum. Bull. 106 18
Rev. Rul. 54-269, 1954-2 Cum. Bull. 114 ..... 15, 16, 27
Rev. Rul. 55-94, 1955-1 Cum. Bull. 419 15
Rev. Rul. 55-503, 1955-2 Cum. Bull. 577 15
Sen. Rep. No. 406, 80th Cong., 1st Sess. 4 52
Sen. Rep. No. 627, 78th Cong., 1st Sess. 26, 58 47
Sen. Rep. No. 1375, 84th Cong., 2d Sess. 1 27
Sen. Rep. No. 1622, 83d Cong., 2d Sess. 52, 276, 277, 284-286 ..... 19, 20, 48, 49, 50
S.M. 3451, IV-2 Cum. Bull. 83 17

Treasury Regulations 111:

§ 29.52-1 15
§ 29.129-3(1) 47

Treasury Regulations 118:

§ 39.41-2(c) 30
§ 39.46-1 30
§ 39.129-3(h)(1) 47

IN THE

Supreme Court of the United States

OCTOBER TERM, 1956

No. 64

LIBSON SHOPS, INC., *Petitioner,*

v.

GUSTAVE F. KOEHLER, District Director of Internal Revenue, *Respondent.*

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Comes now Newmarket Manufacturing Company, by its counsel, and respectfully prays for leave to file a brief as *amicus curiae* in the above-entitled proceeding, and as grounds for this motion advises the Court of the following:

1. This proceeding involves an important question relating to the net operating loss deduction under sections 23(s) and 122 of the Internal Revenue Code of 1939. The question is whether the losses of a component corporation before a statutory merger may be carried over against profits of the resulting corporation after the merger.

2. Newmarket Manufacturing Company is a corporation chartered under the laws of Delaware. It is respondent in *United States* v. *Newmarket Manufacturing Company*, No. 216, October 1956 Term, which involves a question under the same sections. The question is whether losses sustained after a mere change in corporate domicile through a statutory merger may be carried back against profits earned before the change in domicile.

3. On June 28, 1956, the United States filed a Petition for a Writ of Certiorari in the *Newmarket* case. The Petition stated, as a basis for granting the Writ, that the question in the *Newmarket* case is similar to the question in this proceeding, and requested that its disposition be held in abeyance pending the Court's decision in this proceeding. On July 26, 1956, Newmarket Manufacturing Company filed a Brief in Opposition to the Petition.

4. The taxpayer in this proceeding filed its brief on the merits on September 27, 1956. Newmarket Manufacturing Company did not move before said date for leave to file a brief as *amicus curiae* in this proceeding because it could not then be determined whether the Company would have any interest providing a suitable ground for such a motion.

5. After the present term of Court began, counsel for Newmarket Manufacturing Company awaited the disposition of the Petition in the *Newmarket* case. The Court, however, has neither granted nor denied the Petition. Therefore, counsel for Newmarket Manufacturing Company is now under the impression that the Court will not dispose of the Petition until after its decision in this proceeding.

6. Counsel for Newmarket Manufacturing Company believes that the decision in this proceeding may substantially affect the disposition of the *Newmarket* case. In this connection, the Government is explicitly arguing in this proceeding that the Court of Appeals' decision in the *Newmarket* case is erroneous. (Resp. Br. 33.).

7. Counsel for Newmarket Manufacturing Company accordingly desires to submit to the Court significant legal matters which have not been explored by counsel for the taxpayer or counsel for the Government in this proceeding. These matters include tax statutes, legislative materials, administrative interpretations, and related considerations which warrant the thoughtful appraisal of the Court. Counsel for Newmarket Manufacturing Company believes that unless these matters are submitted for the Court's analysis, the issues before the Court will not be adequately presented and the Court will not be fully informed with respect to their appropriate resolution. He is particularly concerned in this respect because, in his view, there are serious errors and omissions in the brief submitted by the Government in this proceeding.

WHEREFORE, it is respectfully prayed that the Court grant this motion for leave to file a brief as *amicus curiae* in this proceeding.

Respectfully submitted,

LOUIS EISENSTEIN,
Counsel for Amicus Curiae

BRIEF FOR NEWMARKET MANUFACTURING COMPANY AS AMICUS CURIAE

STATEMENT

For the convenience of the Court we summarize anew the relevant facts in *United States* v. *Newmarket Manufacturing Company:*

On November 7, 1944, Newmarket Manufacturing Company was organized under the laws of Massachusetts. It engaged in the business of weaving synthetic fabrics. On September 26, 1951, a corporation bearing the same name was chartered under the laws of Delaware in order to remove the corporate domicile of the business to that state. The sole purpose of the change was to forestall the possible application of the Massachusetts Corporate Franchise Tax with respect to sales made in New York. Both courts below have agreed that this objective was a bona fide corporate purpose.[1] The authorized capital stock of the Delaware corporation consisted of 450,000 shares, with a par value of $2.50 per share. Of this total, 400 shares were temporarily issued to the Massachusetts corporation for $1,000 in cash. Between September 26, 1951, and November 30, 1951, the Delaware corporation did not carry on any business or incur any liabilities. Its sole asset was the $1,000. (R. 10-11, 49.)

At the close of business on November 30, 1951, the Massachusetts corporation was merged into the Delaware corporation. On the same day Articles of Consolidation were duly filed in Massachusetts and an Agreement of Merger in Delaware. No steps were taken to dissolve the Massachusetts corporation pursuant to any provisions of Massachusetts law. Under the Agreement of Merger the outstanding certificates in the Massachusetts corporation became certificates in the resulting corporation. The certificate for the 400 temporary shares was cancelled.

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[1] 233 F. 2d at 495.

After the merger the resulting corporation had the same business as the Massachusetts corporation, as well as the same officers and stockholders. Its operations continued in the same place and in the same manner. (R. 11-12, 19-49.)

Under the Agreement of Merger "the corporate identity, existence, purposes, powers, franchises, rights, and immunities" of the Massachusetts corporation were "merged into" and "fully vested" in the "Surviving Corporation."[2] The latter, "without other transfer," succeeded to "all the rights, privileges, powers, franchises and immunities" of "the Constituent Corporations," subject to "the restrictions, disabilities and duties of each of the Constituent Corporations." All their property was "thereafter as effectually the property of the Surviving Corporation" as of "the respective Constituent Corporations." All their liabilities attached to "the Surviving Corporation" and were enforceable against it "to the same extent as if" they "had been incurred or contracted by it." (R. 33, 42-43.)

Both the Massachusetts corporation and the resulting corporation reported their income on the basis of a fiscal year ending November 30th. The resulting corporation filed the return and paid the tax for the fiscal year ending November 30, 1951. It sustained a net operating loss of $660,370.97 for the fiscal year ending November 30, 1952. Later it filed a refund claim for the fiscal year 1951 on the ground that the loss was allowable as a net operating loss carry-back to that year. The claim was denied and this suit followed. The District Court rendered judgment in favor of the Government. The Court of Appeals reversed. (R. 5-8, 11-14, 49-55; Pet. 6-18.)

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[2] While this provision was subject to any exception "otherwise specifically set forth," no such exception was made.

SUMMARY OF ARGUMENT

This case, like the *Newmarket* case, involves the appropriate application of section 122 of the Internal Revenue Code of 1939. Section 122 provides that if "the taxpayer" has a net operating loss, the loss is "a net operating loss carry-back" to a prior year or "a net operating loss carry-over" to a later year. Two conclusions derive from section 122. First, if a business has merely changed its corporate domicile through a statutory merger, losses sustained after the merger may be carried back against profits earned before the merger. Second, if corporations are combined through a statutory merger, losses of a component corporation before the merger may be carried over against profits of the resulting corporation after the merger.

I.

According to the Government, a loss sustained after a mere change in corporate domicile cannot be carried back on the ground that "the taxpayer" which earned the prior profit is not "the taxpayer" which sustained the later loss. But as the First Circuit has held, neither the letter nor the purpose of section 122 requires the result sought by the Government. If a business simply reincorporates via a statutory merger, the taxable entity remains the same because the attributes of corporate existence continue unimpaired. For purposes of the carry-back the change in corporate domicile is no different from a change in individual domicile. This conclusion is amply supported by the settled administrative practice of the Treasury. It is also confirmed by section 381 of the Internal Revenue Code of 1954, which builds on the premise that the carry-back is allowable under the Code of 1939.

In order to support its position the Government has invoked the aid of *New Colonial Co.* v. *Helvering*, 292 U.S. 435 (1934). However, that decision does not apply to a statutory merger—a succession by operation of law to the

attributes of corporate existence. In addition, the argument which the Government imputes to the *New Colonial* decision is directly opposed to this Court's decision in *Helvering* v. *Metropolitan Edison Co.*, 306 U.S. 522 (1939). While the Government has tried to distinguish the *Metropolitan Edison* decision, the alleged distinction is untenable. Our view of the *New Colonial* and *Metropolitan Edison* cases is the same as the administrative view of the Treasury which Congress has recognized and approved.

After a mere change in domicile the resulting corporation is liable for the tax of the "prior year" as "the taxpayer;" it pays the tax for that year as "the taxpayer;" and it sustains the loss for the later year as "the taxpayer." It does not suddenly cease to be "the taxpayer" when its loss as "the taxpayer" is applied to reduce its liability as "the taxpayer." In other contexts the Government will readily agree that a new domicile does not *ipso facto* create a new taxpayer. The Government cannot treat the same corporation as "the taxpayer" and not as "the taxpayer" in the light of whichever result happens to favor the Government.

II.

The resulting corporation in a statutory merger is "the taxpayer" with respect to the prior taxable years of its component corporations. Hence it may carry over the losses previously sustained by a component corporation. In holding otherwise the decision of the Eighth Circuit departs from the relevant tax statutes, conflicts with a familiar pattern of adjudication, and ignores a persuasive administrative practice.

Section 122 must be read in conjunction with section 3797(a)(14) of the 1939 Code, which defines the term "taxpayer." The courts have repeatedly held, in accordance with the definition, that the resulting corporation is "the taxpayer" in regard to the previous opera-

tions of a component corporation. There is no reason to suspect or surmise that "taxpayer" has a peculiarly different connotation in section 122. Our view conforms to the "established policy" which the Treasury itself adopted and applied over an extended period. Until last year the Treasury regularly held that a resulting corporation could carry over prior losses of a component corporation. The Treasury's administrative practice is highly persuasive evidence of the meaning projected by section 122.

The Government asserts that if the carry-over is allowed, local law will improperly determine who is "the taxpayer." This argument misconceives the position which it criticizes. State law, of course, determines the rights and obligations which a resulting corporation acquires from a constituent corporation in a statutory merger. But federal law determines, in the light of its own uniform standard, whether the resulting corporation is "the taxpayer" with respect to the constituent corporation. Under that standard the resulting corporation is "the taxpayer" if it is endowed by operation of law with the rights and obligations of the constituent corporation. In final analysis, the essential difference between our view and the Government's view is that they focus on diverse aspects of local law. The Government contends that the controlling consideration is whether the resulting corporation and constituent corporation are initially chartered under the same certificate. We contend that the crux of the matter is whether the resulting corporation succeeds to the legal attributes of the constituent corporation.

The Government argues that the allowance of the carry-over will sanction tax avoidance because the losses of one corporation can then be offset against the profits of another. However, Congress has specifically indicated that there is no problem of avoidance here. Whenever Congress has been disturbed by avoidance through mer-

gers, it has expressly addressed itself to that problem. And Congress has continuously been undisturbed where, as in this case, a new group of stockholders has not acquired control or, indeed, any interest in the resulting corporation. In talking of tax avoidance the Government is improvising a tax policy of its own which Congress has consistently rejected. Moreover, even under the Government's view the profits of one corporation can be combined with the losses of another.

ARGUMENT

The decision in this case, as in the *Newmarket* case, turns on the appropriate application of sections 23(s) and 122 of the Internal Revenue Code of 1939. Section 23(s) allows taxpayers a "net operating loss deduction computed under section 122." Section 122, in turn, is a formidable statute which prescribes various rules for the required calculation. It first defines a "net operating loss" as the excess of deductions over gross income. It then provides that if "the taxpayer" has a net operating loss, the loss is "a net operating loss carry-back" to a prior year or "a net operating loss carry-over" to a later year. The "amount of the net operating loss deduction" is "the aggregate of the net operating loss carry-overs and of the net operating loss carry-backs to the taxable year," subject to various adjustments which are immaterial here.

"Tax statutes, no less than other statutes, derive vitality from the obvious purposes at which they are aimed." *Griffiths* v. *Commissioner*, 308 U.S. 355, 358 (1939). See also *Haggar Co.* v. *Helvering*, 308 U.S. 389, 394 (1940). Here the animating purpose is scarcely obscure. Loss carry-backs and loss carry-overs were designed to ameliorate the "unduly drastic consequences" of taxing income on an annual basis. *Lewyt Corp.* v. *Commissioner*, 349 U.S. 237, 244 (1955). Cf. *Burnet* v. *Sanford & Brooks Co.*, 282 U.S. 359 (1931). The losses of one year are applied against the profits of another, so

that the resulting tax reflects a more "realistic, balanced picture" of the enterprise. *Manning* v. *Seeley Tube & Box Co.*, 338 U.S. 561, 566. (1950). Or as the Second Circuit has stated in a comparable context, "it was considered equitable that lean years should be set off against lush ones" in order to "strike some sort of average." *Stanton Brewery* v. *Commissioner*, 176 F. 2d 573, 574 (2d Cir. 1949). See further Sen. Rep. No. 1631, 77th Cong., 2d Sess. 51 (1942); *United States* v. *Olympic Radio & Television*, 349 U.S. 232, 234 (1955).

The language and policy of section 122 readily yield two conclusions. First, if a business has merely changed its corporate domicile through a statutory merger, losses sustained after the merger may be carried back against profits earned before the merger. Second, if corporations are combined through a statutory merger, losses of a component corporation before the merger may be carried over against profits of the resulting corporation after the merger. Hence the decision of the First Circuit in the *Newmarket* case is correct and the decision of the Eighth Circuit in this case is erroneous. We shall now discuss both conclusions in the same order within the context of the two cases.

I.

IF A BUSINESS HAS MERELY CHANGED ITS CORPORATE DOMICILE THROUGH A STATUTORY MERGER, LOSSES SUSTAINED AFTER THE MERGER MAY BE CARRIED BACK AGAINST PROFITS EARNED BEFORE THE MERGER

In the *Newmarket* case the First Circuit dealt with a carry-back as authorized by section 122(b)(1)(B) of the 1939 Code. Section 122(b)(1)(B) states: "If for any taxable year beginning after December 31, 1949, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for the preceding taxable year." Clearly, the resulting corporation sustained "a net operating loss," and the "loss" occurred in a "taxable year beginning after December 31, 1949." Therefore,

the loss was treated as "a net operating loss carry-back for the preceding taxable year." The Government agrees that if the corporate domicile were still the same, the carry-back would be allowable. However, it insists that since the domicile was changed, the carry-back is gone. And so the legal issue is narrow and precise. Does the right to a carry-back strangely disappear if an enterprise moves its corporate domicile for a bona fide business purpose? The Court of Appeals easily resolved this question against the Government. It held that nothing in the statute required the bizarre result desired by the Government.

A. We turn to the Government's effort to justify its singular position. The Government contends that the deduction must be denied because the resulting corporation is not "the taxpayer" with respect to the year in which the carry-back would apply. The reasoning in behalf of this conclusion is essentially simple. Under section 122, the Government states, "the taxpayer" which earns the prior profit must also be "the taxpayer" which sustains the later loss. But, it continues, the Massachusetts corporation and the resulting corporation were different taxpayers; and they were different taxpayers because they were separate corporate entities.[3] In our view this reasoning is as dubious as it is simple. Indeed, we are rather puzzled by the Government's argument; on other occasions it has easily reasoned differently.[4]

The Government's abundant talk of "corporate entity" has little relevance in the present context. But it has the marked virtue of illustrating a cogent observation by Mr. Justice Cardozo. "Catch words and labels," he wrote, "are subject to the dangers that lurk in metaphors and symbols, and must be watched with circumspection lest they put us off our guard." *Henneford* v. *Silas Mason*

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[3] For the details of this reasoning, see Resp. Br. 8, 11, 19.

[4] See pp. 15-17, 25-26, *infra*.

Co., 300 U.S. 577, 586 (1937).[5] Here the Government is methodically doing what Mr. Justice Cardozo wisely deplored. It has casually assumed that familiar phrases like "corporate entity" are appropriate substitutes for adequate analysis. We need hardly observe that legal tags "are not instruments of adjudication but statements of result." See *Wisconsin* v. *J. C. Penney Co.*, 311 U.S. 435, 444 (1940). And in tax law, too, labels and clichés may effectively beg the question to be answered. Perhaps even worse, they may almost obscure what is otherwise clear. Compare *Helvering* v. *Clifford*, 309 U.S. 331 (1940), in which this Court perceptively probed the concept of "ownership."

As Henderson long ago indicated, a corporation is an aggregate of legal attributes invested with a single name. See Henderson, *The Position of Foreign Corporations in American Constitutional Law* 165-168 (1918). Cf. Gray, *The Nature and Sources of the Law* 50-57 (2d ed. 1948); Dewey, *The Historic Background of Corporate Legal Personality*, 35 Yale L. J. 655 (1926). The phrase "corporate entity" is a convenient verbalism for summarizing what Chief Justice Marshall called the "qualities and capacities" conferred by law. Cf. *Dartmouth College* v. *Woodward*, 4 Wheat. 518, 636 (1935). At the very least, then, the "entity" continues as long as the attributes continue unimpaired. Of course, the legal essence of a statutory merger is that it maintains intact the attributes which constitute "the corporate *persona*" or "existing corporate life." *Guaranty Trust Co.* v. *N. Y. & Q. C. Ry. Co.*, 253 N.Y. 190, 200, 201, 170 N.E. 887, 890, 891 (1930).[6] This is precisely what happened when the corporate domicile was

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[5] Judge Learned Hand has gone further. He has diagnosed legal metaphors as "ordinarily a symptom of confused thinking." *Kingston Dry Dock Co.* v. *Lake Champlain Transp. Co.*, 31 F. 2d 265, 267 (2d Cir. 1929).

[6] See further pp. 20-23, 32-33, *infra*.

changed by a statutory merger under the laws of Massachusetts and Delaware. See Mass. Ann. Laws c. 156, § 46D (1948); Del. Rev. Code as amended c. 65, §§ 59-60 (1935). In the words of the Delaware statutes, after the merger "all the rights, privileges, powers and franchises" of each constituent corporation, as well as "all" its "property, real, personal and mixed," were "vested" in the resulting corporation; "and all property, rights, privileges, powers and franchises, and all and every other interest" were "thereafter as effectually the property of the resulting or surviving corporation as they were of the several and respective constituent corporations." Moreover, "all rights of creditors and all liens upon any property of any of said constituent corporations" were "preserved unimpaired," and "all debts, liabilities and duties of the respective constituent corporations" attached to the "resulting or surviving corporation," and were enforceable "against it to the same extent as if said debts, liabilities and duties had been incurred or contracted by it."[7]

In short, the attributes which are loosely described as "corporate entity" plainly survived the change in domicile. If they failed to survive, we are unable to understand the merger statutes under which the change occurred. In fact, as we shall shortly note, for other purposes the resulting corporation and the Massachusetts corporation are clearly

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[7] See also Mass. Ann. Laws c. 156, § 46D(b)(2); and p. 6, *supra*. The District Court excluded from the rights acquired by the resulting corporation "any right" which it "could not have exercised under the law under which it existed immediately prior to the merger." R. 49, *United States* v. *Newmarket Manufacturing Company*. We are a little puzzled by this exclusion, especially since the corporate purposes of the Masachusetts corporation were no broader than those of the resulting corporation. The latter was organized under the laws of Delaware, and so those laws determine the extent of its rights after the merger. See *Aspinook Corp.* v. *Commissioner of Corporations & Taxation*, 326 Mass. 327, 329, 94 N.E. 2d 366, 367 (1950). Under the Delaware statutes it acquired all the rights of the Massachusetts corporation.

the same taxable entity.[8] Admittedly, the migration from one state to another may entail the acceptance of new obligations and burdens. But the same is no less true if an individual moves from one state to another. Yet the Government would scarcely suggest that an individual entrepreneur cannot balance the losses suffered after his change of domicile against the profits realized before the change. By the same token, as Judge Magruder observed, "Income-tax-wise, there is no more reason why the Congress should choose to attach crucial significance to a mere change of corporate domicile than it would to a change of an individual taxpayer's domicile from Massachusetts to Delaware." In using the words "the taxpayer" Congress could not have required "the thin distinction between Newmarket Mfg. Co. before and after its incorporation in Delaware." 233 F. 2d at 497, 498.[9]

We are pretty much saying what the Treasury has said on other occasions. It is the settled view of the Treasury that where a business reincorporates, the taxable entity remains the same if the corporate rights and liabilities continue undisturbed. G.C.M. 24423, 1945 Cum. Bull. 145; Rev. Rul. 54-269, 1954-2 Cum. Bull. 114. Both of these rulings construed section 52 of the 1939 Code, which provides that "Every corporation" subject to the income tax "shall make a return." In G.C.M. 24423 the Treasury considered whether a new taxable entity was created on the conversion of a state bank into a national bank. If

[8] See pp. 25-26, 33-37, *infra*.

[9] During the two months before the statutory merger the Delaware corporation did not qualify as a full-fledged taxable entity because it was still quiescent. It had not earned any income, transacted any business, or perfected its organization by issuing stock to its contemplated stockholders. See Regulations 111, § 29.52-1; Rev. Rul. 55-503, 1955-2 Cum. Bull. 577. Cf. I.T. 3871, 1947-2 Cum. Bull. 62; Rev. Rul. 55-94, 1955-1 Cum. Bull. 419. When a corporate domicile is moved, there is usually a short interval between the acquisition of the new charter and the consummation of the change.

so, then the old entity and the new entity had to file separate returns for the year in which the conversion occurred. The "fundamental question," the Treasury said, "is whether, in fact, a new legal entity is created upon conversion." The correct answer, it then added, depends on "an interpretation of the section of law pursuant to which the conversion is accomplished." After appraising the relevant section the Treasury held that a new taxable entity was not created and hence only one return was "required for the entire taxable year." 1945 Cum. Bull. at 146-147. The Treasury particularly relied on this Court's decision in *Metropolitan Bank* v. *Claggett*, 141 U.S. 520 (1891), which held that the entity is "one and the same" before and after the change. The "same body" continues "with the same officers and stockholders," as well as "the same property, assets," and "business." *Id.* at 527.

The Treasury reasoned similarly in Rev. Rul. 54-269. There a corporation had been organized under special acts of Connecticut. State law authorized it to surrender its special charter for a new charter under the general corporation statutes. If it elected to do so, "its corporate existence" was deemed to "continue," but without "either the privileges or obligations" of the special acts "under which it was originally incorporated." The corporation turned in its special charter and filed a new certificate under the general statutes. Again the question was whether for federal tax purposes the resulting corporation was "a continuation of the same corporation" or "a new separate taxable entity." And again the answer turned on the continuation of the corporate attributes under the governing local law. While the corporation now functioned under a new certificate, it was still the same "taxable entity." The loss of "privileges" bestowed by the special acts was dismissed as immaterial. At the same time the Treasury carefully distinguished the case where the attributes of corporate life come to an end and the

property is sold to another corporation. *Id.* at 115. In that situation, the Treasury held, the vendee corporation is a "distinct" entity.[10] For further rulings to the same effect, see I.T. 2005, III-1 Cum. Bull. 299 (1924); C.S.T. 13, 1945 Cum. Bull. 430; and cf. G.C.M. 11387, XII-1 Cum. Bull. 427 (1933). But cf. S.M. 3451, IV-2 Cum. Bull. 83 (1925), involving a purchase of corporate assets.

These rulings seem to leave little more to be said, except as the Government has proceeded to ignore them.[11] Here, as there, the corporation merely reincorporated in response to its business needs. And under the explicit terms of the reincorporation the existing corporate "rights, privileges, powers and franchises" remained intact. Therefore, as the First Circuit concluded, its decision approved a principle which had already "proved acceptable to the Commissioner." 233 F. 2d at 499. If a corporation constitutes the same taxpayer for the purpose of filing a single tax return, it certainly constitutes the same taxpayer for the purpose of applying a loss carry-back.[12]

B. The First Circuit's conclusion is further confirmed by section 381 of the Internal Revenue Code of 1954. Section 381 provides for the transfer of various tax "items" from one corporation to another. It con-

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[10] The Treasury also held that if the corporate attributes terminate rather than continue, the situation falls within the principle of *New Colonial Co.* v. *Helvering*, 292 U.S. 435 (1934), discussed at pp. 20-29, *infra*.

[11] In its brief (Resp. Br. 19) the Government refers to section 52, but refrains from mentioning these rulings. And despite these rulings it boldly and erroneously declares (at p. 20) that section 52 has "always been recognized as demanding separate returns by a predecessor and successor corporation . . . of their respective incomes for the periods covering their respective lives."

[12] In view of the Treasury's rulings the First Circuit's conclusion seems *a fortiori* correct. The present question is whether the resulting corporation is the same "taxpayer" rather than the same "corporation." See pp. 43-45, *infra*.

sists of three subsections. Subsection (a) states the so-called "general rule" for the section. The transfer of items is allowed where all or substantially all the property of a corporation is acquired by another corporation in one of four types of tax-free reorganization. Among them is the reorganization described in section 368(a)(1)(F) of the 1954 Code, which was formerly section 112(g)(1)(F) of the 1939 Code. This reorganization is "a mere change in identity, form, or place of organization, however effected." The simple change of domicile in the *Newmarket* case was a "mere change" of this kind. 233 F. 2d at 497.[13] Subsection (b) of section 381 sets forth "operating rules" or "conditions and limitations" which apply to the transfer of items otherwise allowed. It declares that except "in the case of an acquisition in connection with a reorganization described in" section 368(a)(1)(F), the transferee corporation "shall not be entitled to carry back a net operating loss for a taxable year ending after" the transfer "to a taxable year" of the transferor corporation.[14] Subsection (c) of section 381 enumerates a number of items which are transferred from one corporation to another. These items include loss carry-overs, but they do not include loss carry-backs.

Section 381 is particularly revealing here. Neither subsection (a) nor subsection (c) grants a loss carry-back to a successor corporation. Yet subsection (b) provides

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[13] The Government has not disputed that the merger was "a mere change" in "place of organization" within the meaning of section 112(g)(1)(F) of the 1939 Code. Cf. *George Whittell & Co.*, 34 B.T.A. 1070 (1936); Rev. Rul. 54-193, 1954-1 Cum. Bull. 106.

[14] Subsection (b) also provides that a mere change in corporate domicile does not affect the taxable year of the enterprise. The change neither closes the taxable year nor starts a new one. The same taxable entity is deemed to continue, as the Treasury has held under the 1939 Code. See pp. 15-17, *supra*.

"operating rules" which obviously assume that the carry-back is allowable where the business has merely changed its corporate domicile. In these circumstances only one inference seems reasonable. Section 381 plainly presupposes that under prior law a loss carry-back is already available if there is but "a mere change" in the "place of organization." Unless the section is viewed in this light, there is no deduction to which the "operating rules" can apply in such cases. Nor is there any doubt that section 381 contemplates a loss carry-back in favor of the resulting corporation if a business is merely reincorporated elsewhere. To quote the report of the Senate Finance Committee, "assume corporation X merges into corporation Y on December 31, 1954, in a statutory merger with Y's charter continuing after the merger. If Y has a net operating loss in 1955, such loss cannot be carried back to a taxable year of X but shall be a carry-back to a taxable year of Y. If, however, corporation X, in a reorganization described in subparagraph (F) of section 368(a)(1), merely changes its identity, form, or place of organization, the resulting corporation is entitled to carry back its net operating loss to a taxable year of X prior to the reorganization." Sen. Rep. No. 1622, 83d Cong., 2d Sess. 276 (1954). Cf. H. R. Rep. No. 1337, 83d Cong., 2d Sess. A135 (1954). See further Mertens, Law of Federal Income Taxation, Code Commentary § 381(b):2 (1955).

This quotation necessarily summarizes the law of loss carry-backs in the 1939 Code, as well as in the 1954 Code, where there is a mere change of corporate domicile. For as we have just indicated, the 1954 Code does not contain any new provision which grants the carry-back in this situation. It simply picks up where the 1939 Code left off. It builds on the premise that the carry-back is already allowed and continues to allow it. In short, the

carry-back allowed under the 1954 Code is equally allowed under the 1939 Code.[15]

C. In order to justify its conclusion the Government has invoked the aid of *New Colonial Co.* v. *Helvering*, *supra*.[16] The First Circuit correctly held that the *New Colonial* decision is out of place here. 233 F. 2d at 498.

In the *New Colonial* case a corporation was engaged in the business of producing and selling ice. It became financially embarrassed, and a new corporation was organized to take over the enterprise. The stockholders exchanged their shares in the old corporation for shares in the new corporation, which then acquired the assets of the business. Later the new corporation carried forward the operating losses of the old corporation. This Court held that the losses were not available because the new corporation was not the same taxpayer as the old corporation.

We fail to see how the Government derives much comfort from the *New Colonial* decision. There, as the Court expressly noted, the "corporate existence of the old corporation continued" for almost two years, though "it transacted no business and had no assets or income." 292 U. S. at 438. The entity which sustained the loss still remained separate and apart from the entity which claimed the loss. For that matter, the old entity was still free to embark on a new business and to apply the loss carry-over against any income earned in that business. If the tax-

[15] We are not unaware of the general statement in the committee reports that "No inference is to be drawn from the enactment" of section 381 "whether any item or tax attribute may be utilized by a successor or a predecessor corporation under existing law." H. R. Rep. No. 1337, 83d Cong., 2d Sess. A135 (1954); Sen. Rep. No. 1622, 83d Cong., 2d Sess. 277 (1954). In the case of carry-backs, however, section 381(b) is meaningful only as it incorporates "existing law."

[16] See Resp. Br. 11-16, 21-23.

payer's position was correct, there were in effect two taxpayers entitled to the same carry-over. And so, as Judge Magruder aptly declared, "What is conclusive, we think, is that the *New Colonial* case did not involve a statutory merger"—a succession by operation of law to the attributes of corporate existence. 233 F. 2d at 498. Indeed, in the *New Colonial* case this Court pointedly stated that the "transaction was voluntary and contractual, not by operation of law." 292 U.S. at 441.[17]

Moreover, the argument which the Government imputes to the *New Colonial* decision is directly opposed to this Court's opinion in *Helvering* v. *Metropolitan Edison Co.*,

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[17] The Government, by way of footnote (Resp. Br. 23, n. 7), has tried to dismiss this significant statement. It argues that a merger is just as "voluntary and contractual" as other kinds of inter-corporate transfers. If the argument is correct, we must infer that this Court painstakingly made a meaningless statement. However, there is no reason to indulge in this dim view of what the Court carefully said. In distinguishing a transaction "by operation of law," the Court used a familiar legal expression as lawyers ordinarily understand it. And the expression, as usually understood, refers to statutory mergers of corporate attributes in gross. In *United States* v. *Seattle Bank*, 321 U.S. 583 (1944), which involved the tax consequences of a statutory merger, the Government made a similar argument that failed to persuade. The Court's observations there equally apply here. As the Court stated, "in a broad sense, few if any transfers ever take place 'wholly by operation of law' for every transfer must necessarily be a part of a chain of human events, rarely if ever other than voluntary in character." The phrase "operation of law" focuses upon "the immediate mechanism by which the transfer is made effective. If that mechanism is entirely statutory, effecting an automatic transfer without any voluntary action by the parties, then the transfer may truly be said to be 'wholly by operation of law.'" *Id.* at 587-588. Cf. *Oswego Falls Corp.*, 26 B.T.A. 60, 75-76 (1932), *aff'd*, 71 F. 2d 673 (2d Cir. 1934). Even the Government is not convinced by its essay in semantics. Elsewhere in its brief it correctly assumes that the phrase "operation of law" refers to statutory mergers in the customary legal sense. Resp. Br. 35-38.

306 U.S. 522 (1939). In that case a subsidiary corporation issued bonds at a discount. Later it was absorbed by its parent corporation, which then retired the bonds. The issue before the Court was whether the resulting entity could deduct the unamortized discount and related expenses attributable to the bonds. In resolving this question the Court meticulously contrasted "a true merger or consolidation" and a sale of assets. A deduction is allowable, the Court held, "if there has been a true merger or consolidation whereby the identity of the corporation issuing the bonds continues in the successor and the latter becomes liable for the debts of the former by operation of law." On the other hand, a deduction is no longer available after "a mere sale by one corporation of all its assets to another which assumes the liabilities of the former." 306 U.S. at 526. The Court then sustained the disputed deduction because the fusion of the two corporations had "all the elements of a merger" and came "within the principle that the corporate personality of the transferor is drowned in that of the transferee." *Id.* at 529.

Judge Magruder has nicely distilled the essence of the *Metropolitan Edison* decision. "What the Court was saying, of course, was that the transferee in a statutory merger should be deemed to be continuing in itself the corporate life of the now-defunct component, and that it followed from this conceptual identity that the two corporate entities were to be treated for a substantive purpose in the income tax as the same taxpayer." 233 F. 2d at 499. The Government's present understanding of the *New Colonial* opinion runs headlong into this basic principle of the *Metropolitan Edison* opinion. True, the Government has made a heroic attempt to distinguish between the two cases. But the result scarcely justifies the effort.

The Government admits that under the *Metropolitan Edison* decision statutory mergers are significantly different from non-merger transactions. However, it contends

that the decision is "far removed" from the present dispute over net operating losses.[18] While the argument is not entirely clear to us, we shall try to summarize it. If a bond indebtedness is assumed in a merger, the Government says, the resulting corporation "*itself* sustains the unamortized bond discount loss *after* the reorganization, and hence can deduct the loss *as its own.*" But in non-merger transactions, whether they are taxable or tax-free, the consideration is adjusted "to reflect prospective losses and expenses attributable to the bonds," and therefore the successor corporation does not sustain a loss when payment is later made.[19] This argument completely misses the point of the *Metropolitan Edison* decision. As the Second Circuit has expressed the controlling principle, the deduction for amortization carries over because in a merger "the transferee corporation succeeds by operation of law to all the rights and liabilities of the former company and carries forward its identity." *American Gas & Elec. Co.* v. *Commissioner*, 85 F. 2d 527, 530 (2d Cir. 1936). See *Stanton Brewery* v. *Commissioner*, *supra*, at 57; *Koppers Company* v. *United States*, 134 F. Supp. 290, 296 (Ct. Cls. 1955); *E. & J. Gallo Winery* v. *Commissioner*, 227 F. 2d 699, 703 (9th Cir. 1955).[20]

The Government has managed to forget what it previously said in the *Metropolitan Edison* case itself. After thoughtfully analyzing the decisions the Government declared with assurance that the "only sound" basis for the amortization deduction is that "the identity of the

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[18] Resp. Br. 35-39.

[19] *Id.* at 37-38. (Italics in original.)

[20] For additional statements of the principle, see *Turner-Farber-Love Co.* v. *Helvering*, 68 F. 2d 416, 417 (D.C. Cir. 1933); *American Gas & Electric Co.* v. *United States*, 17 F. Supp. 151, 157 (Ct. Cls. 1936); *Illinois Power & Light Corp.*, 33 B.T.A. 1189, 1196 (1936); *Connecticut Electric Service Co.*, 35 B.T.A. 444, 449 (1937).

issuing corporation was preserved," and not that "the survivor considered as a separate corporation sustained a loss of its own." Brief for the Petitioner, pp. 46-47, *Helvering* v. *Metropolitan Edison Co., supra.* The wisdom of the Government's earlier view is easily sustained by an example. *A* and *B* are two corporations; *A* has issued bonds at a discount; and the assets of *A* are to be acquired by *B*. If *B* acquires the assets in a tax-free reorganization by issuing its stock to the shareholders of *A* in exchange for the stock of *A*, then *B* is not entitled to any deduction for amortization with respect to the bonds. But if *A* merges into *B* and the stockholders of *A* acquire a similar portion of *B*'s stock, then *B* is entitled to the deduction. See *American Gas & Electric Co.* v. *United States, supra,* at 157.[21] Yet in both cases the bond obligation is similarly assumed, and in both cases the amount of stock issued by *B* to the shareholders of *A* is adjusted "to reflect prospective losses and expenses attributable to the bonds."

In the *New Colonial* case this Court left little doubt that the net operating loss deduction and the bond amortization deduction turn on the same basic principle. For at the close of its opinion the Court referred approvingly to *Turner-Farber-Love Co.* v. *Helvering, supra,* which dealt with amortization of discount, and, like the *Metropolitan Edison* case, dwelt on the difference between a merger and other transfers of corporate assets. 292 U.S. at 441.[22] Here, as elsewhere, we are again merely saying what the Government has already said. In the *Metropolitan Edison* case the Government considerably emphasized

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[21] See further other cases cited in note 20, *supra.*

[22] The Court coupled the *Turner-Farber-Love* decision with *Athol Mfg. Co.* v. *Commissioner,* 54 F. 2d 230 (1st Cir. 1931), involving a loss carry-over. See further *American Gas & Elec. Co.* v. *Commissioner, supra,* at 530, where these two decisions are similarly cited as illustrations of the same principle.

that the rule of the *New Colonial* case extends to deductions for amortization as well as deductions for losses.[23] It particularly indicated that, in so far as mergers are concerned, no distinction should be drawn between the deduction of losses and the deduction of amortization. "Upon the general reasoning" in the *New Colonial* opinion, the Government observed, "*it is possible to argue* that even in the case of a true merger or consolidation" the resulting corporation "is nevertheless to be regarded as a separate taxable entity and is not entitled to deductions for losses or for amortization of bond discount or expense which would have been allowable to its predecessor if it had continued in business, although the Court did point out that there the transaction was voluntary and contractual and not by operation of law."[24] Apparently, as of early 1939, when the *Metropolitan Edison* case was argued and decided, the Treasury was by no means firmly persuaded that the *New Colonial* decision extends to loss deductions by corporations resulting from a statutory merger.

More recently the Treasury has ruled, as we are now saying, that the *Metropolitan Edison* case and the *New Colonial* case are to be read *in pari materia*. If the corporate succession is by operation of law, the former applies. If it is not by operation of law, the latter applies. P.S. No. 62, 5 C.C.H. Fed. Tax Rep. ¶6118 (1950).[25] On this occasion the Treasury dealt with the carry-forward of

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[23] See Brief for the Petitioner, pp. 19, 38 *et seq.*, *Helvering* v. *Metropolitan Edison Co.*, *supra*. The Government noted that the *New Colonial* opinion cited the *Turner-Farber-Love* case "with approval." *Id.* at 19.

[24] *Id.* at 42. (Italics supplied.) The remainder of the Government's argument sought to establish that the corporate transactions in the *Metropolitan Edison* case did not constitute a "true" merger.

[25] For the convenience of the Court we are including the whole of P.S. No. 62 in the Appendix.

contributions made to an exempt employees' pension trust. Section 23(p)(1)(A) of the 1939 Code provides that "an employer" may deduct "an amount not in excess of 10 per centum" of the cost of funding past service credits. A contribution beyond this limitation is "deductible in the succeeding taxable years." The corporate employer in this case had funded the past service credits; had deducted 10 percent of the cost in each of three years; and had then merged into another company. The question was whether the resulting corporation could deduct the balance of the contribution in later years. This problem, the Treasury declared, "is one to be resolved in accordance with the line of distinction to be drawn between" the *New Colonial* decision and the *Metropolitan Edison* decision. Since the corporate assets had been acquired "pursuant to a statutory merger which by operation of law effected a fusion of the assets and liabilities of the respective companies," the resulting corporation could deduct the balance "to the same extent as" the component corporation "would have been entitled had it continued in business."[26]

Congress has expressly confirmed the views of the Treasury as carefully articulated in P.S. No. 62.[27] In January of this year Congress enacted an amendment relating to the carry-over of excess contributions to an

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[26] Section 381(c)(11) of the 1954 Code now specifically covers the carry-over of pension contributions made by a predecessor corporation.

[27] The Government has evidently struggled a good deal with the obvious purport of P. S. No. 62. It tries to escape embarrassment by noting that there the taxpayer "assumed the obligations under the pension plan." Resp. Br. 40. We doubt whether this observation helps matters too much. In transfers other than mergers the same obligation is equally assumed; yet under P. S. No. 62 the carry-over is nevertheless denied. The only basis for the diverse results is the principle which that ruling enunciates. Moreover, P. S. No. 62 deals with the carry-over of a pre-merger outlay, as in the case of losses—not "post-merger expense," as the Government for some reason thinks. Resp. Br. 39.

employees' trust. Pub. L. No. 396, 70 Stat. 7, 84th Cong., 2d Sess. The statute extends the benefit of such carry-overs to certain situations where a subsidiary corporation has liquidated its assets into its parent corporation under section 112(b)(6) of the 1939 Code. These are cases in which the applicable local law prevented a statutory merger because the two corporations were organized in different states. In these restricted circumstances the amendment treats the liquidation as if it were a merge and hence the parent corporation is allowed to deduct the excess contributions made by the subsidiary corporation. For present purposes the accompanying committee reports are very informative. See H.R. Rep. No. 1594, 84th Cong., 1st Sess. 2 (1955); Sen. Rep. No. 1375, 84th Cong., 2d Sess. 1 (1956). "Under the 1939 Code," they state, "whether tax benefits and elective rights were available to a successor corporation when the assets of two or more predecessor corporations were combined in a tax-free reorganization or liquidation depended upon the legal form in which the combination was effectuated." The reports then indicate that the amendment is designed to grant a carry-over which is otherwise already allowed where the subsidiary corporation is merged into the parent corporation. In other words, within its narrow compass the statute equalizes tax-free liquidations with tax-free mergers. Of course, the amendment is intelligent tax legislation only as it correctly presupposes an existing tax distinction between mergers and other intercorporate transfers.[28] We may no less confidently state that the statute is a plain-spoken legislative approval of administrative practice—actual rather than presumed.[29]

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[28] For a similar distinction by the Treasury, see further Rev. Rul. 54-269, *supra*, at 115, which is discussed at pp. 16-17, *supra*.

[29] Cf. *Helvering* v. *Winmill*, 305 U.S. 79 (1938); *Helvering* v. *Reynolds Co.*, 306 U.S. 110 (1939); *Helvering* v. *Oregon Insurance Co.*, 311 U.S. 267 (1940); *Commissioner* v. *Wheeler*, 324 U.S. 542 (1945); *Bochm* v. *Commissioner*, 326 U.S. 287 (1945).

Finally, we should add that in this Court the Government has already successfully made the same distinction with respect to loss carry-backs.[30] In *Standard Paving Co.* v. *Commissioner*, 190 F. 2d 330 (10th Cir. 1951), a parent corporation dissolved a subsidiary corporation. Later the parent corporation sought to carry back its losses against income of the subsidiary corporation. The Tenth Circuit disallowed the carry-back on the basis of the *New Colonial* case.[31] The parent corporation then applied for certiorari on the ground that the Tenth Circuit's decision was in conflict with the Second Circuit's decision in *Stanton Brewery* v. *Commissioner, supra.*[32] The Government, however, opposed the petition because the alleged conflict was non-existent. It made the very argument which we are making now. "The assertion of conflict," said the Government, "is not well founded." The *Stanton Brewery* decision "was based squarely on the premise that the resulting corporation in a merger is the same taxpayer as the component corporation. Here there was no merger. . . ." Brief for the Respondent in Opposition, p. 15, *Standard Paving Co.* v. *Commissioner*, 342 U.S. 860 (1951). In response to the Government's argument this Court denied certiorari.[33] If the *Stanton Brewery* decision is not at odds with the *Standard Paving* decision, it is equally at ease with the *New Colonial* decision.[34] Conflicts

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[30] For the Treasury's administrative practice to the same effect, see also pp. 38-39, *infra*.

[31] See also *Eleanor H. Vendig*, 22 T.C. 1127 (1954). Cf. *Follansbee Steel Corp.* v. *United States*, 109 F. Supp. 635 (W.D. Pa. 1953); *Donohue* v. *United States*, 112 F. Supp. 660 (E.D. Mo. 1953).

[32] See pp. 39-45, *infra*.

[33] Compare *Gramm Trailer Corp.*, 26 T.C. No. 84 (1956), where the Tax Court similarly distinguished between a merger, which continues the "powers, privileges and immunities" of a corporation, and a liquidation, which brings them to an end.

[34] The Government did not request certiorari in the *Stanton Brewery* case, though it now insists that there is a sharp conflict with the *New Colonial* decision.

do not appear and disappear to suit the periodic preferences of the Government in a particular case.

Perhaps Judge Learned Hand has provided the best commentary on the present significance of the *New Colonial* decision. While he dissented at length in the *Stanton Brewery* case, he did not consider the *New Colonial* decision relevant enough to mention. See 176 F. 2d at 578.[35]

D. The crux of the matter seems fairly obvious. If the corporate domicile had remained the same, the carry-back would have been allowable. We fail to understand why a mere change in corporate domicile produces a significant change in tax consequences. Congress devised loss carry-backs and carry-overs in order to aid business and stimulate enterprise. See H.R. Rep. No. 855, 76th Cong., 1st Sess. 9-10 (1939). They are important instruments of fiscal policy which are designed to foster economic growth and stability. We are unaware of any reason for supposing that Congress sought to distinguish between a business which moves its domicile and a business which retains its domicile. And the Government has not pointed to any statute which compels such a whimsical conclusion. We may put the same conclusion a little differently. The resulting corporation was liable for the tax of the prior year as "the taxpayer;"[36] it paid the tax for that year as "the taxpayer;" and it sustained the loss for the later year as "the taxpayer." It did not suddenly cease to be "the taxpayer" when its loss as "the taxpayer" was applied to reduce its liability as "the taxpayer." This conclusion makes good sense as well as good law.

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[35] We are not implying that the Government is always anxious to apply the *New Colonial* decision even where it evidently applies. The Government's views tend to remain flexible. It may overlook the decision if it can collect more tax by doing so. See, *e.g.*, *Mary Miller*, 22 T.C. 293 (1954).

[36] See pp. 33-36, *infra*.

Undoubtedly, in other circumstances the Government would gladly agree with us that a new domicile does not *ipso facto* make a new taxpayer. We shall cite two random illustrations. Under section 41 of the 1939 Code "the taxpayer" cannot change his method of computing income unless he secures the consent of the Commissioner. See Regulations 118, § 39.41-2(c).[37] Similarly, under section 46 of the 1939 Code "a taxpayer" cannot change "his accounting period" unless he obtains "the approval of the Commissioner." See Regulations 118, § 39.46-1.[38] If the Government's present view is correct, a corporate taxpayer can freely change its accounting method or its accounting period without pausing to consult the Commissioner. It need only change its domicile through a statutory merger. For according to the Government, the resulting corporation is then a new taxpayer which starts off afresh. Yet we are sure that if a corporate taxpayer made any such argument, the Commissioner would be quite unimpressed. And so here we may appropriately invoke a venerable principle which is as relevant in tax law as elsewhere. What is good for the goose is also good for the gander. Or to alter the metaphor, principles of tax law do not mysteriously change because the shoe is on one foot rather than the other. See Magruder, J., in *Portland Oil Co.* v. *Commissioner*, 109 F.2d 479, 487-488 (1st Cir. 1940), *cert. denied*, 310 U.S. 650 (1940). Cf. *Pearce* v. *Commissioner*, 315 U.S. 543, 547 (1942). The Government cannot treat the same corporation as "the taxpayer" and not as "the taxpayer," in the light of "whichever favors the Government." Cf. *Rosenman* v. *United States*, 323 U.S. 658, 663 (1945).

In sum, the deduction which the First Circuit sustained falls well within the language and policy of section 122.

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[37] Section 41 of the 1939 Code has been succeeded by sections 441 and 446 of the 1954 Code.

[38] Section 46 of the 1939 Code has been succeeded by section 442 of the 1954 Code.

In the words of the Second Circuit, our view is "the one which will carry out the evident statutory purpose," since it assures carry-backs and carry-overs to "what is essentially a continuing enterprise, entitled to all their benefits in ameliorating otherwise harsh tax consequences of fluctuating profits or expanding business." *Stanton Brewery v. Commissioner, supra,* at 577.

II.

IF CORPORATIONS ARE COMBINED THROUGH A STATUTORY MERGER, LOSSES OF A COMPONENT CORPORATION BEFORE THE MERGER MAY BE CARRIED OVER AGAINST PROFITS OF THE RESULTING CORPORATION AFTER THE MERGER

We have argued that a mere change in corporate domicile through a statutory merger does not entail a forfeiture of the net operating loss deduction. And so we further submit, as the First Circuit held, that our position is correct regardless of what the answer may be in this case, where a number of corporations were merged into one. See 233 F. 2d at 497, 499.[39] In any event, however, the decision of the Eighth Circuit should be reversed for the reasons we shall now explore.

A. In the present case sixteen corporations were engaged in the business of selling women's wear. Another corporation provided management services for them. They were all controlled by the same persons in the same relative proportions. The sales corporations merged into the management corporation. Under the applicable local statutes the resulting corporation succeeded by operation of law to all the rights and obligations of the component corporations. In computing its income for the first taxable year after the merger, the resulting corporation deducted net operating loss carry-overs deriving from the prior operations of three component corporations. The Commissioner disapproved the deduction and the Court of

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[39] Cf. Resp. Br. 34-35.

Appeals for the Eighth Circuit sustained his determination. 229 F. 2d 220 (8th Cir. 1956). It disallowed the carry-overs on the ground that the resulting corporation and the component corporations were not the same "taxpayer" under section 122. In our view this decision departs from the relevant tax statutes; it conflicts with a familiar pattern of adjudication; and it ignores a persuasive administrative practice.

Section 122, like other provisions in the 1939 Code, must be read in conjunction with a second statute which the Government has ignored throughout its analysis. We are referring to section 3797, in which Congress has defined various basic terms that appear in the Code.[40] Among these terms is the word "taxpayer"—the very word in dispute here. Subsection (a)(14) of section 3797 defines "taxpayer," as used in the Internal Revenue Title, as "any person subject to a tax imposed by this title"—unless "otherwise distinctly expressed or manifestly incompatible with the intent thereof."[41] The courts have repeatedly held that the resulting corporation in a statutory merger or consolidation is "the taxpayer" with respect to the prior taxable years of a component corporation. It is "the taxpayer" because it is the person "subject to" the taxes for those years; and it is the person "subject to" the taxes for those years because it succeeds by operation of law to the attributes of the component corporation. See *Stanton Brewery* v. *Commissioner, supra,* at 575-576. Hence it "is obligated and birthmarked by statute" with "all" the "primary liability" which adheres to those attributes. *Bowman Hotel Corp.*, 24 B.T.A. 1193, 1203 (1931). The Court of

[40] To illustrate, while the Government has criticized the Second Circuit's decision in *Stanton Brewery* v. *Commissioner, supra,* it does not in the least mention section 3797, which the Second Circuit considered very pertinent. See Resp. Br. 28-32.

[41] Section 3797(a)(1) defines "person" as including a "corporation."

Claims has aptly summarized the matter. "The surviving corporation in a statutory merger represents the combination of a business that was operated before in the form of its constituents. For practical, business, and many tax purposes, it is treated the same as many of its components which formed it. It accedes to the rights and privileges as well as the obligations of its components by operation of law. It becomes primarily liable for the tax obligations of its components as the taxpayer and not secondarily liable as a transferee." *Koppers Company* v. *United States, supra,* at 295.

For example, section 272(a)(1) of the 1939 Code provides, "in the case of any taxpayer," that if the Commissioner asserts a deficiency against "the taxpayer" in a stated manner, "the taxpayer" may file a petition with the Tax Court for a redetermination. The resulting corporation is "the taxpayer" which is entitled to file the petition in response to an alleged deficiency of a component corporation. *Bowman Hotel Corp., supra; Trahern Pump Co.,* 27 B.T.A. 363 (1932); *Skaneateles Paper Co.,* 29 B.T.A. 150 (1933), *aff'd on another issue,* 71 F. 2d 584 (7th Cir. 1934); *Alaska Salmon Co.,* 39 B.T.A. 455 (1939); *Falstaff Brewing Corp.,* P.-H. B.T.A. Memo. Dec. ¶ 39,371 (1939); *Northern Ohio Railway Co.,* 6 T.C.M. 1230 (1947). Cf. *Bond Crown & Cork Co.,* 19 T.C. 73 (1952); *International Mining Corp.,* P.-H. B.T.A. Memo. Dec. ¶ 41,146 (1941). Again, section 276(b) authorizes the Commissioner and "the taxpayer" to extend the time for assessing a deficiency. The resulting corporation is "the taxpayer" which may prolong the period for assessing taxes attributable to a component corporation. *Phillips* v. *Lyman H. Howe Films Co.,* 33 F. 2d 891 (3d Cir. 1929); *Commissioner* v. *Oswego Falls Corp.,* 71 F. 2d 673 (2d Cir. 1934); *Skaneateles Paper Co., supra;* G.C.M. 7310, IX-1 Cum. Bull. 237 (1930). Cf. *United States* v. *Oswego Falls Corp.,* 113 F. 2d 322 (2d Cir. 1940).

The Government pretty much concedes that the cases just cited have been correctly summarized. It seeks to avoid them by suggesting that they recognize a successor corporation as "the same taxable entity" as a predecessor corporation "solely for the purpose of enforcement or redetermination of the surviving tax liabilities."[42] But these accepted holdings cannot be so easily disparaged as involving procedural issues. Procedure is a means to an end. To say that a resulting corporation is "the taxpayer" for procedural purposes is only to say in another way that it is "the taxpayer" for substantive purposes. It is "the taxpayer" which may dispute an alleged deficiency because it is "the taxpayer" which is liable for the deficiency if sustained. Otherwise there is little point to the holdings which we have cited. They are rooted in the premise that the resulting corporation is, by operation of law, "liable as principal for the obligations" of the component corporation. *United States* v. *Oswego Falls Corp., supra,* at 325. As the Tax Court has concisely stated, the statutes which fix this liability "are more than rules of procedure—they are rules of property." *Bowman Hotel Corp., supra,* at 1206. See also *Commissioner* v. *Oswego Falls Corp., supra,* at 676; *Stanton Brewery* v. *Commissioner, supra,* at 575-576; *Skaneateles Paper Co., supra,* at 157; *Alaska Salmon Co., supra,* at 456; G.C.M. 7310, *supra,* at 239. Cf. *Bailey* v. *Railroad Company,* 22 Wall. 604, 629-630, 640 (1874).

If any doubts remain, they are fully resolved by other decisions to which we now turn. For these decisions emphasize that the component corporation and resulting corporation are the same "taxpayer" for substantive purposes, too. The net effect of the former's operations before the merger enters into the latter's calculation of gain or loss after the merger.

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[42] Resp. Br. 26-27.

Section 505(a)(1) of the 1939 Code grants a deduction for federal income taxes paid or accrued in the taxable year.[43] It is well settled, of course, that taxes are deductible only by the person on whom they are imposed. The deduction is not available to someone else though he has assumed the burden of paying them.[44] In *Adrian & James, Inc.*, 4 T.C. 708 (1945), a resulting corporation paid and deducted the income tax computed on the prior earnings of a component corporation.[45] The Commissioner disapproved the deduction. He declared that the deduction was confined to payments "by a taxpayer in discharge of a liability for its own income taxes," as distinguished from payments "in discharge of a liability for such taxes of another corporation." Then he inferred that the deduction was not allowable on the ground that the resulting corporation had paid the tax "as an assumed debt and not as an income 'tax liability' of its own." *Id.* at 717-718. The Tax Court was only partially persuaded. It concurred in the Commissioner's statement of principle, but not in his attempted application. It concluded that "under a statutory merger the payment by the surviving corporation of Federal income taxes due from a merged corporation" is "payment of a tax liability of the surviving corporation and consequently deductible by it." *Id.* at 718.

The Tax Court returned to the same theme in *Koppers Coal Co.*, 6 T.C. 1209 (1946). A resulting corporation had paid interest on tax deficiencies attributable to several component corporations, and then deducted the payment

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[43] The deduction is allowed in computing the personal holding company tax.

[44] *Magruder* v. *Supplee*, 316 U.S. 394 (1942). Two years ago Congress made a narrow exception for local taxes on real estate which are apportioned between seller and buyer. Int. Rev. Code of 1954, § 164.

[45] This decision construed section 406(a)(1) of the 1938 Act, 52 Stat. 561, which became section 505(a)(1) of the 1939 Code.

as "interest" on "indebtedness." See Int. Rev. Code of 1939, § 23(b). The Commissioner again denied the deduction on the theory that the liabilities were not the indebtedness of the resulting corporation. The Tax Court was still unconvinced. It emphasized anew that a resulting corporation is "not a transferee" but "in fact the predecessor corporations;" that "the income tax liabilities of such corporations" are "consequently the indebtedness of the new corporation;" and that "in paying such indebtedness" the resulting corporation is "not satisfying the indebtedness of another." The interest which it pays is interest on its own indebtedness. 6 T.C. at 1223. See further *A. D. Saenger*, 38 B.T.A. 1295 (1938). But cf. *Rodney, Inc.* v. *Commissioner*, 145 F. 2d 692 (2d Cir. 1944), where the corporation was dissolved rather than merged.

The cases which we have cited are well fortified by this Court's decision in *Helvering* v. *Metropolitan Edison Co., supra.*[46] See also, to the same effect, *Western Maryland Ry. Co.* v. *Commissioner*, 33 F. 2d 695 (4th Cir. 1929); *New York Central R. Co.* v. *Commissioner*, 79 F. 2d 247 (2d Cir. 1935), *cert. denied*, 296 U.S. 653 (1935); *American Gas & Elec. Co.* v. *Commissioner, supra; American Gas & Electric Co.* v. *United States, supra; Illinois Power & Light Corp.*, 33 B.T.A. 1189 (1936); *Connecticut Electric Service Co.*, 35 B.T.A. 444 (1937).[47] The *Metropolitan Edison* decision and all the other cases rest on a familiar hornbook principle. A resulting corporation "takes on the obligations" of a component corporation "directly by operation of law." *Stanton Brewery* v. *Commissioner, supra,* at 575. Or to return to Judge Magruder's way of putting

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[46] See pp. 21-26, *supra.*

[47] Compare further, in regard to the capital stock tax, *Early* v. *Southgate Corp.*, 136 F. 2d 217 (4th Cir. 1943); *United States* v. *Northwestern Nat. Bank & T. Co. of Minneapolis*, 137 F. 2d 761 (8th Cir. 1943).

it, the two corporations are "treated for a substantive purpose in the income tax as the same taxpayer."

In the light of our analysis the appropriate conclusion seems clear. The resulting corporation in a statutory merger is "the taxpayer" with respect to the prior taxable years of its component corporations. Hence when carry-overs attributable to a component corporation are involved, the same "taxpayer" is offsetting earlier losses against later gains. In denying the carry-overs in the present case, the Eighth Circuit has simply held that the words "the taxpayer" mean something different from what they usually mean in the 1939 Code. However, there is no reason to suspect or surmise that these words have a peculiar connotation in section 122. In section 3797 Congress has supplied its own dictionary of meaning for the term "taxpayer," and that meaning has been repeatedly applied. True, section 3797 indicates that its definitions may not apply in a particular context if a different meaning is "distinctly expressed" or the usual meaning is "manifestly incompatible" in the specific setting. See p. 32, *supra*. But nothing within or without section 122 in the least suggests that the usual meaning must be replaced here. While the connotation of a word may vary, it does not follow that diverse meanings should be gratuitously discovered—especially where Congress has emphasized that any departure from its definition must be "distinctly" stated or "manifestly" required. And so "the changeable meaning" which the Government prefers for present purposes cannot be justified. Cf. *United States* v. *Olympic Radio & Television, supra,* at 235; *Commissioner* v. *Estate of Bedford*, 325 U.S. 283, 292 (1945); *Crane* v. *Commissioner,* 331 U.S. 1, 8, 12 (1947). As the Court of Claims has stated, "if the surviving corporation is treated for tax purposes as the same 'taxpayer' as its components or predecessors, the carry-backs and carry-overs are covered by the code." *Koppers Company* v. *United States, supra,* at 294.

The view which we are taking only echoes the view which the Government itself "adopted and followed" over "many years." *Koppers Company* v. *United States, supra,* at 296. To quote its own candid admission, the Government had "an established policy" that "following a statutory merger or consolidation the resultant corporation should be granted the privilege of carrying over or carrying back net operating losses across the line of fusion, provided no violation of Section 129 or other applicable provision of the Code or Regulation was involved."[48] This policy was expressed in "unpublished rulings" which reflected the Treasury's "administrative position" in its "handling of cases." The rulings held that "except in instances where the merger or consolidation is brought about for the purpose of tax avoidance, the corporation surviving a statutory merger or consolidation" would "be permitted to carry over a net operating loss of a component in that merger to the extent that the absorbed corporation would have been able to carry over that loss had it continued its separate existence; also that a resultant corporation would be permitted to carry back across the line of merger a net operating loss limited to the portion of such loss that is allocable to assets received by the resultant corporation from a merged component whose premerger income is sought to be offset." Brief for the United States, pp. 20-21, *Koppers Company* v. *United States, supra.*[49] Only in March of last year did the Government forsake its "established policy." *Id.* at 3.[50]

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[48] The significance of section 129 is considered at pp. 45-50, *infra.*

[49] This "established policy" on loss carry-backs and carry-overs "had evolved from a continuing study of the entire subject, it having previously been the position of the Chief Counsel that although a resultant corporation should be granted the tax privileges which its component corporations would have enjoyed had they continued their separate existence, an exception should be made in the case of net operating losses." *Id.* at 3.

[50] For further evidence of the Treasury's prior "established policy," see *Morrisdale Coal Mining Co.*, 19 T.C. 208, 210 (1952), where the Commissioner conceded that a resulting corporation was entitled to carry over a loss sustained by a component corporation.

We believe that the Government was right before and is wrong now. Its understanding of section 122 has not improved with additional meditation.[51] In any event, the administrative practice of the Treasury is highly persuasive evidence of the meaning projected by the statute. And that practice should not be rejected in the absence of very cogent considerations which make disapproval inevitable. See *Logan* v. *Davis*, 233 U.S. 613, 627 (1914); *Great Northern Ry. Co.* v. *United States*, 315 U.S. 262, 275 (1942). Nor is it particularly important that the Treasury has recently tried to reverse itself. The Treasury's change of mind does not express any peculiar specialized knowledge or experience. It merely mirrors an erroneous view of this Court's decision in the *New Colonial* case. Therefore, it is not entitled to any particular deference as an administrative construction. Cf. *Helvering* v. *Hallock*, 309 U.S. 106, 121 (1940); *White* v. *Winchester Club*, 315 U.S. 32, 39 (1942); *Great Northern Ry. Co.* v. *United States*, *supra*, at 275.

B. Our conclusion is amply buttressed by the Second Circuit's decision in *Stanton Brewery* v. *Commissioner*, *supra*, and the Court of Claims' decision in *Koppers Company* v. *United States*, *supra*. While these cases involved the unused excess profits credit carry-over and carry-back,[52] their essential reasoning applies no less to the net operating loss carry-over and carry-back.[53]

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[51] The Government says, "In cases involving the question whether net operating losses may cross the line of a statutory merger, the Government has consistently urged that they may not and that *New Colonial* controls." Resp. Br. 40-41. In view of the Government's administrative practice, this statement is no less remarkable than wrong. For our discussion of the *New Colonial* decision, see pp. 20-29, *supra*.

[52] Int. Rev. Code of 1939, § 710(c).

[53] As the Government recently declared, "No significant difference between carry-backs and carry-overs of unused excess profits credits and net operating loss carry-backs and carry-overs is apparent." Brief for the United States, p. 10, *Koppers Company* v. *United States*, *supra*.

In the *Stanton Brewery* case an operating company merged into its parent company, which continued to carry on the same business. For its first taxable year after the merger the resulting corporation deducted the component corporation's unused excess profits credits of the two previous years. The carry-overs were more than enough to remove all current excess profits tax liability. The Second Circuit sustained the carry-overs in an opinion by Judge Clark. His analysis is admirably cogent and thorough.[54] The deduction is approved because the resulting corporation is "an all-embracing whole which absorbs the rights and privileges, as well as the obligations, of its constituents." 176 F. 2d at 575. Since it is "subject to" the tax obligations of the component corporation, it is also "the taxpayer." In the *Koppers* case a parent and three subsidiaries merged into a newly formed corporation.[55] The latter then sought to apply an unused excess profits credit carry-back against the income reported by the component corporations on a consolidated excess profits tax return. Once more the Commissioner disallowed the deduction, and once more he was reversed. The reasoning of the Court of Claims was closely akin to the reasoning of the Second Circuit. See also *E. & J. Gallo Winery* v. *Commissioner, supra.*[56]

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[54] Judge Learned Hand dissented. 176 F. 2d at 578. But his disagreement rested largely on a special group of excess profits tax statutes providing an alternative base period credit for a so-called "acquiring corporation." See Int. Rev. Code of 1939, §§ 740, 742. Compare, however, the Court of Claims' contrary reasoning from the same statutes in *Koppers Company* v. *United States, supra,* at 293-294.

[55] The parent and one of the subsidiaries were Massachusetts trusts. The other two subsidiaries and the resulting corporation were chartered by Delaware.

[56] See also *Moldit; Inc.* v. *Jarecki,* 53-2 U.S.T.C. ¶ 9551 (N.D. Ill. 1953), *appeal dismissed pursuant to stipulation,* 7th Cir., July 26, 1954 (net operating loss carry-back). But cf. *Commonwealth Title Co.* v. *Rothensies,* 124 F. Supp. 274 (E.D. Pa. 1954) (net op-

The Government is not kindly disposed toward the *Stanton Brewery* decision. It particularly criticizes the decision for allegedly holding that "local law is to govern who is 'the taxpayer' entitled to carry over a federal tax credit or loss from one year to another." On the basis of this criticism, the Government also accuses the decision of ignoring "the settled principle" that federal tax statutes are to be construed in a uniform manner in accordance with their own criteria.[57] These observations display a failure in analysis which is somewhat surprising. The *Stanton Brewery* opinion does not say what the Government criticizes it for saying. And the Government relies no less on local law than the decision which it disapproves.

We cheerfully concede that the question whether a corporation is "the taxpayer" is "a federal question." This issue "is not resolved by local characterization" that reflects matters of local concern. The fact that a resulting corporation is deemed "the taxpayer" under state law does not determine that it is "the taxpayer" under federal law. Cf. *Lyeth* v. *Hoey*, 305 U.S. 188, 193 (1938); *United States* v. *Pelzer*, 312 U.S. 399, 402 (1941); *Estate of Rogers* v. *Commissioner*, 320 U.S. 410, 413 (1943). But this truism does not mean that state law can be scrupulously disregarded as the Government seems to believe. With few exceptions corporations are creatures of state law, and state law determines their rights and obligations. *Hopkins Savings Assn.* v. *Cleary*, 296 U.S. 315 (1935). Indeed, as we previously observed, a corporation is but

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erating loss carry-over and unused excess profits credit carry-over). The Tax Court has refused to abide by the *Stanton Brewery* decision. See *California Casket Co.*, 19 T.C. 32, 39 (1952) (unused excess profits credit carry-over); *E. & J. Gallo Winery*, 12 T.C.M. 414, 415 (1953), *rev'd*, 227 F. 2d 699 (9th Cir. 1955) (unused excess profits credit carry-over). Its reluctance to do so derives essentially and erroneously from *New Colonial Co.* v. *Helvering*, *supra*. Compare, however, *Gramm Trailer Corp.*, *supra*; and see further discussion at pp. 20-29, *supra*.

[57] Resp. Br. 30-31. See also *id.* at 25-26.

an aggregate of rights and obligations which the law treats as a person. See pp. 13-14, *supra*. The content of those rights and obligations must be consulted if federal law is not to operate in a vacuum. See, *e.g.*, *Helvering* v. *Metropolitan Edison Co.*, *supra*, at 526 *et seq.* Hence "an inquiry into state law seems inescapable." *Helvering* v. *Fuller*, 310 U.S. 69, 74 (1940). See also *Hulburd* v. *Commissioner*, 296 U.S. 300, 315 (1935); *Magruder* v. *Supplee*, *supra*, at 396. Cf. *United States* v. *Loan & Bldg. Co.*, 278 U.S. 55, 59 (1928).

What this Court said in *Morgan* v. *Commissioner*, 309 U.S. 78 (1940), is especially illuminating here. "State law creates legal interests and rights. The federal revenue acts designate what interests or rights, so created, shall be taxed. Our duty is to ascertain the meaning of the words used to specify the thing taxed. If it is found in a given case that an interest or right created by local law was the object intended to be taxed, the federal law must prevail no matter what name is given to the interest or right by state law." *Id.* at 80-81. See also *Helvering* v. *Stuart*, 317 U.S. 154, 162 (1942). If we may slightly revise the language of the *Morgan* opinion, state law determines the rights and obligations which a resulting corporation acquires from a component corporation via a statutory merger. Federal law determines, in the light of its own uniform standard, whether the resulting corporation is "the taxpayer" with respect to the component corporation. And, as we have already indicated, that standard is now well fixed. The resulting corporation is "the taxpayer" if it is endowed by operation of law with the rights and obligations of the component corporation. See p. 36, *supra*. It is entirely immaterial whether state law continues to call the two corporations "distinct" rather than "identical." Cf. *Burk-Waggoner Assn.* v. *Hopkins*, 269 U.S. 110, 114 (1925). But the federal standard must inevitably apply to the substance of what local law has created, for otherwise there is nothing to which the standard can apply.

Actually the Government is no more oblivious of local law than we are. The essential difference between its view and our view is that they focus on diverse aspects of local law. We contend, as the cases have held, that the resulting corporation is "the taxpayer" in relation to a constituent corporation if the former succeeds to the latter's rights and obligations. The Government contends that the resulting corporation is "the taxpayer" in regard to a constituent corporation only if both are initially chartered under the same certificate.[58] The Government's argument stands or falls on no more than this simple proposition. It is all a matter of one or two pieces of paper. We doubt whether even the Government truly approves this approach to the solution. For as we have seen, the Treasury has ruled that a predecessor corporation and a successor corporation are the same taxable entity if the corporate attributes continue essentially undisturbed. See 15-17, *supra*. And the same rulings unmistakably indicate that this conclusion ultimately rests on the content of applicable local law.

Nor is the Government on stronger ground when it strenuously insists that in any event the resulting corporation and its component corporations are not the "same" or "identical." In the present case, for example, the Government urges that the relevant state statutes "do not purport to erase, or to deny recognition to, the separate existences of the transferor and transferee corporations, and that they do not purport to authorize a deduction by one of the corporations of net operating losses sustained by the other for purposes of computing their respective federal income tax liabilities." Then the Government adds what we do not dispute—that the merger laws of a state can confer "only what it is within the power of the state to give; that is, rights, privileges and obliga-

[58] All the corporations involved in a statutory merger are "constituents," no matter which becomes the "resulting corporation."

tions created by the laws of that particular state.'" They cannot be read as creating credits or deductions under federal revenue laws, passing with corporate assets, like good will or trademarks."[59]

We need not probe this reasoning to determine whether it is beyond criticism. Even if it is wholly impeccable, it is beside the point. "In law also the right answer usually depends on putting the right question." *Estate of Rogers* v. *Commissioner, supra,* at 413. The question here is not whether the resulting corporation after a merger may be properly considered the same "corporation" as a component corporation for purposes of local law. The question rather is whether the resulting corporation is "the taxpayer" with respect to the component corporation for purposes of federal tax law. As the Second Circuit has explained in *Stanton Brewery* v. *Commissioner, supra,* the carry-over or carry-back adheres to "the taxpayer," not to "the corporation." And so, under the controlling standard of federal law,[60] the allowance turns on "the simple determination of the laws of corporate rights and liabilities," without any need to unravel "difficult and complex questions of corporate entity." It is enough that the resulting corporation, as "taxpayer," is "liable for the taxes" of the component corporation,

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[59] Resp. Br. 25, n. 9. See also *id.* at 31.

[60] See p. 42, *supra.* This conclusion does not mean, as the Government seeks to argue, that the availability of the carry-over hinges on "whether the local law purports to treat tax deduction privileges created by Congress as assignable from one corporate taxpayer to another." Resp. Br. 31, n. 14. We are not even slightly suggesting that the right to the carry-over derives from a grant by local law. The content of local law is relevant only for the purpose of ascertaining whether the resulting corporation qualifies as "the taxpayer" in accordance with the federal standard.

"whatever may be the merits of the academic controversy over their fate." 176 F. 2d at 576.[61]

The Government has one other quarrel with the *Stanton Brewery* decision which merits but a few words. It contends, in oblique fashion, that the resulting corporation is liable as transferee, and not as "taxpayer," with respect to the prior operations of a component corporation.[62] This argument is no more than an elementary error, and the Government should surely know better. The resulting corporation is not secondarily liable as transferee. It is "primarily liable" as "the taxpayer." See, *e.g.*, the distinction drawn in *Koppers Coal Co., supra,* at 1223, between the liability of a taxpayer and the liability of a transferee. See further *Oswego Falls Corp., supra,* at 68-76, *aff'd*, 71 F.2d at 676; *A. D. Saenger, supra,* at 1302; and discussion at pp. 32-37, *supra.*

C. In order to persuade this Court to affirm the decision below the Government raises the specter of tax avoidance. Unless the carry-over is denied, says the Government, a taxpayer may "reduce its own average business income" with "losses sustained by other taxpayers in other businesses." The taxpayer's interpretation "would extend the benefits of section 122 "to a corporation which absorbs another corporation with a history of operating losses, with a view to deducting the losses from its own future income. In effect, it would lend judicial approval to the exploitation, for bargaining purposes, of the tax benefits afforded by the net operating loss carry-over provisions."[63] This kind of eloquent argument is often the last refuge when all other arguments fail. As Judge

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[61] Cf. *Aspinook Corp.* v. *Commissioner of Corporations & Taxation,* 326 Mass. at 331, 94 N.E. (2d) at 368: "Under the Delaware statute it is only 'the *separate* existence of all the constituent corporations' which 'shall cease.' From the moment of consolidation the 'existence' of each of these corporations is to be a combined existence manifested solely through and operating in the name of the consolidated corporation." (Italics in original.)

[62] Resp. Br, 31, n. 15.

[63] *Id.* at 44, 45.

Magruder has recently observed, while a desire to save taxes is not "rightly" significant, "it sometimes is permitted to give a spurious flavor" to an argument. *Channing* v. *Hassett*, 200 F. 2d 514, 516 (1st Cir. 1952). See also *Commissioner* v. *Korell*, 339 U.S. 619, 625-626 (1950). Fortunately, we need not spend much time on the fears which the Government would like to create. Here Congress has specifically spoken on the subject of tax avoidance and left little more for the Government to say. We are referring to section 129 of the 1939 Code, which Congress enacted in 1943. Revenue Act of 1943, § 128, c. 63, 58 Stat. 21.

Section 129 is directed against acquisitions made to avoid income or excess profits taxes. Specifically, it deals with two kinds of acquisitions: (1) a person or persons acquire "control of a corporation;" and (2) a corporation acquires, in a tax-free transaction, "property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders."[64] If any such acquisition is made and "the principal purpose" of the acquisition is "evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed." Under section 129, then, a deduction is not disallowed merely because new stockholders have acquired corporate control. The deduction is frustrated only if they have obtained control for the proscribed purpose of avoidance.

In enacting section 129 Congress was largely disturbed by the developing practice of acquiring corporations "with current, past, or prospective losses" in order to reduce

[64] Section 129(a) defines "control" as "the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation."

taxes. See H. R. Rep. No. 871, 78th Cong., 1st Sess. 24, 49 (1943); Sen. Rep. No. 627, 78th Cong., 1st Sess. 26, 58 (1943). And Congress was especially attentive to the acquisition of loss corporations through statutory mergers. In the explicit words of the Ways and Means Committee, "This section is designed to put an end promptly to any market for, or dealings in, interests in corporations or property which have as their objective the reduction through artifice of the income or excess profits tax liability." Among "the tax benefits sought" are "carry-overs and carry-backs of losses," and one of "the devices" used is "an acquisition which follows by operation of law in the case of a corporation resulting from a statutory merger or consolidation." H. R. Rep. No. 871, *supra*, at 49.

In view of the text and context of section 129 several conclusions easily emerge. First, Congress recognized that after a merger is completed, prior losses of a component corporation may be deducted from later profits of the resulting corporation.[65] Second, while Congress was sensitively aware of tax avoidance through mergers of loss corporations, it carefully allowed the carry-over even if a new group of stockholders gained "control" of the fused enterprise—unless "the principal purpose" of the merger was tax avoidance. Third, where Congress has so deliberately defined the area of avoidance to be policed, it is not for the Government to speak fearfully of cases which failed to worry Congress. Here, clearly, the mergers were well beyond the line drawn by Congress, for precisely the same individuals were in control before and after the merger. "When such clear choice of ideas has been made in the drafting of a specific provision of the law, its language

[65] The regulations proceed from the same premise. They expressly embrace cases where a profitable corporation is combined with a loss corporation "by such transfer or other action as is necessary to bring" the losses "into conjunction with the income." Regulations 111, § 29.129-3(1); Regulations 118, § 39.129-3(b)(1).

must be taken at its face value." *Helvering* v. *Wood*, 309 U.S. 344, 348 (1940).[66]

The matter does not end there. In 1954, after a decade of administrative experience, Congress re-examined the problem of avoidance, and once more it was unimpressed by the fears which allegedly trouble the Government. Indeed, Congress appreciably broadened the allowance of loss carry-overs to successor corporations, so that tax consequences would "depend less upon the form of the transaction than upon the economic integration of two or more businesses into a unified business enterprise." See Int. Rev. Code of 1954, § 381(a)(b)(c)(1); H. R. Rep. No. 1337, 83d Cong., 2d Sess. 41 (1954); Sen. Rep. No. 1622, 83d Cong., 2d Sess. 52 (1954).[67] In other words, Congress again deemed it wise to permit the losses of one business to be offset against the profits of another business in a

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[66] The Government has argued that under section 122 the profits and offsetting losses must derive from the same business. Resp. Br. 5, 7, 9, 41 et seq. "The provisions of the statute," the Government says, "their legislative history, and the relevant decisions make it clear that the carry-over privilege is not available" unless there is "a continuity of business enterprise, *i.e.*, the current year's income against which the taxpayer seeks to offset the prior year's loss must be derived from substantially the same business as that which produced the loss." *Id.* at 5. We do not know how the Government arrived at this conclusion, for we have found nothing which sustains it. If a taxpayer engages in two or more businesses, carry-backs or carry-overs from one may clearly apply against the earnings from another. Under section 122 the controlling test is not whether the income and the loss derive from the same assets, but whether they are both attributable to the same taxpayer. See further *Northway Securities Co.*, 23 B.T.A. 532 (1931); *Alprosa Watch Corp.*, 11 T.C. 240 (1948); *A. B. & Container Corp.*, 14 T.C. 842 (1950); *Wage, Inc.*, 19 T.C. 249 (1952). In these cases the taxpayer changed its business, and the profits of one enterprise were reduced by allowances of another.

[67] The Government states that "it is far from clear that the deduction in controversy" here "would have been allowable under the 1954 Code." Resp. Br. 18, n. 3. This statement is at odds with the statute just cited.

newly combined enterprise. And Congress again deemed it appropriate to allow the carry-over of losses even though the carry-over may inure to the benefit of a new controlling group. Apart from the prior limitation in regard to "principal purpose,"[68] Congress added only one other condition. After the fusion of various businesses the shareholders of the loss corporation must own at least 20 percent of the stock in the integrated enterprise. Int. Rev. Code of 1954, § 382(b). See Sen. Rep. No. 1622, 83d Cong., 2d Sess. 284-286.[69]

This chapter of legislative history speaks for itself. Whenever Congress has been disturbed by tax avoidance through mergers, it has expressly addressed itself to that problem. But Congress has continuously been undisturbed where, as in the present case, a new group has not acquired control or, indeed, any interest in the resulting corporation.[70] In talking of tax avoidance the Government is dis-

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[68] Section 129 of the 1939 Code has been re-enacted as section 269 of the 1954 Code.

[69] Even this limitation does not apply where, if, as in this case, the corporations involved in the merger "are owned substantially by the same persons in the same proportion." Int. Rev. Code of 1954, § 382(b)(3).

[70] The Government says that section 382(a)(1)(C) of the 1954 Code "precludes a carry-over even by the same corporation unless, among other things, the corporation continues to carry on 'substantially the same' business." Resp. Br. 42. While that statute is not concerned with mergers and is irrelevant here, we should note that the Government's summary of the statute is less than complete. First, the statute does not apply unless there has been a change in ownership of as much as 50 percent of the stock. Second, though such a change in ownership has occurred, the losses of one existing business may be offset against the profits of another existing business, as long as both are continued for at least a limited period. Third, the statue does not bar the addition of a new business, and the carry-over of prior losses against the profits of the new business. See Conf. Rep. No. 2543, 83d Cong., 2d Sess. 40 (1954).

ingenuously improvising a tax policy of its own which Congress has consistently rejected.[71]

The Government's own analysis sheds a revealing light on the solution which it now proposes. For the Government concedes that under its view of section 122 the profit of one corporation can also be combined with the loss of another.[72] A simple example illustrates the nature of the Government's reasoning. Assume that corporations *A* and *B* are engaged in different businesses; and that *A* has profits and *B* has losses. The Government agrees that if *A* merges into *B*, the prior losses of *B* are available as a carry-over against later earnings from assets contributed by *A*. The corporation that takes the deduction derives originally from the same certificate as the corporation that has sustained the loss—and hence they constitute the same legal entity. But if *B* merges into *A*, the carry-over is supposedly gone. To borrow the Government's words, "the availability of the net operating loss deduction" is "de-

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[71] The Government contends that section 381 of the 1954 Code constitutes a change in law with respect to the loss carry-overs of merged corporations. Resp. Br. 17-18. In making this argument it refrains from quoting relevant portions of the Finance Committee report. The report states that under prevailing interpretations of the 1939 Code the carry-over of losses hinges on the form of the reorganization; and then it emphasizes that the rules are being broadened so that the carry-over will "depend less upon the form of the transaction" than its economic effects. Sen. Rep. No. 1622, 83d Cong., 2d Sess. 52 (1954). Of course, we are not relying on section 381 as a retroactive resolution of the present dispute. We are simply denying what the Government is asserting—that a change in statutory language necessarily means a change in law in regard to mergers. In so far as mergers are concerned, the revision more readily indicates that Congress wished to clarify the existing rule applicable to mergers, while extending the same rule to other corporate fusions. Cf. *Helvering* v. *New York Trust Co.*, 292 U.S. 455, 468-469 (1934); *Haggar Co.* v. *Helvering, supra,* at 399-400; *Higgins* v. *Smith, supra,* at 479-480; *Commissioner* v. *Wheeler, supra,* at 545-546.

[72] Resp. Br. 34, n. 16.

pendent upon which of two or more corporations survives a merger."[73] Or to restate this conclusion, the solution "seems to be sought in terms of which legal entity swallowed the other." *Stanton Brewery* v. *Commissioner, supra,* at 574. Due respect for Congress suggests that such "unwitty diversities" should not be freely attributed to it—particularly when they possess no relevance for tax purposes.[74] Cf. *Helvering* v. *Hallock, supra,* at 118.

D. The Government has tried hard to build a small argument on a relief provision enacted in 1947. Act of July 15, 1947, c. 249, 61 Stat. 324, 26 U.S.C.A. § 122 note. Under this statute a railroad emerging from bankruptcy may carry over net operating losses and unused excess profits credits even though it has been reorganized under a new charter and prior corporate attributes have come to an end. See H. R. Rep. No. 624, 80th Cong., 1st Sess. According to the Government, this legislation "affirmatively" shows that after a merger the resulting corporation may not carry over the losses of a component corporation. Otherwise "there obviously would have been no need for the enactment of the 1947 statute."[75]

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[73] *Ibid.*

[74] The Government usually looks askance at such incongruities. It seeks to excuse its present change of mind by resorting to a generality—"tax consequences flow from what the taxpayer does, not from what it might have done." In reply we need only quote what this Court said in response to another aphorism invoked by the Government. "As so broad and unchallenged a principle furnishes only a general direction, it is of little value in the solution of tax problems." *Higgins* v. *Smith,* 308 U.S. 473, 476 (1940). If the generality were as informative as the Government assumes, a good many tax cases which it has won would have been decided differently. See, *e.g., Gregory* v. *Helvering,* 293 U.S. 465 (1935); *Raybestos-Manhattan Co.* v. *United States,* 296 U.S. 60 (1935); *Minnesota Tea Co.* v. *Helvering,* 302 U.S. 609 (1938); *Helvering* v. *Horst,* 311 U.S. 112 (1940). Saws and adages do not decide tax cases.

[75] See Resp. Br. 16-17.

The argument overlooks the purport of the railroad legislation. The statute of 1947 grants, in a closely confined context, a special dispensation for the benefit of new taxpayers. In regard to loss carry-overs of reorganized railroads, it provides that a new taxpayer shall be treated as if it were a continuing taxpayer. A carry-over is allowed regardless of whether the railroad has started corporate life afresh or kept intact the prior attributes of corporate existence.[76] In view of this legislative objective it is similarly immaterial whether the railroad assets have been acquired in a tax-free reorganization.[77] The committee reports expressly note that the amendment covers cases "where the predecessor corporation has continued in existence after the acquisition by the new corporation;" and then they enunciate a principle for allocating carry-overs between the two corporations where both continue to exist.[78]

We do not discern how the statute of 1947 helps the Government. And we are quite surprised that the Government mentions it at all. As the Second Circuit has pointed out, at best the railroad statute "suggests" that the Government is wrong. The purpose of the statute "was limited to remedying inequalities of treatment among the railroads in reorganization, where the reorganized corporation was not regarded as the same taxpayer." It casts no adverse "light upon the situation where a corporation resulting from a merger has been recognized on the authorities as the same taxpayer as its component corpora-

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[76] Needless to say, these railroad reorganizations are sharply dissimilar from statutory mergers because the liabilities of the predecessor corporation are not transferred in gross to the successor corporation. In fact, the basic design of the reorganization is to alter the debt structure.

[77] See Int. Rev. Code of 1939, § 113(a)(20), to which the 1947 statute cross-refers.

[78] See H. R. Rep. No. 624, 80th Cong., 1st Sess. 6 (1947); Sen. Rep. No. 406, 80th Cong., 1st Sess. 4 (1947).

tions." *Stanton Brewery* v. *Commissioner, supra,* at 577. See also *Koppers Company* v. *United States, supra,* at 297; *E. & J. Gallo Winery* v. *Commissioner, supra,* at 706. In the present case the Eighth Circuit did not even regard the statute as sufficiently relevant for discussion.

E. One other small matter remains to be mentioned. Whenever the Government is displeased by a tax deduction, we may expect it to invoke the familiar canon that deductions are a matter of legislative grace. Of course, once more we have not been surprised by any deviation from the usual practice.[79] As on so many other occasions, a tax deduction is regarded as a penal provision directed against the Government and hence to be grudgingly applied in a niggardly fashion.[80] This Court, however, has already said all that need be said on this kind of statutory construction. Deduction statutes, like other tax statutes, are to be applied in response to "the legislative policy expressed in the fair and natural meaning" of the words used by Congress. *Lykes* v. *United States,* 343 U.S. 118, 120 (1952). See also *Commissioner* v. *Korell, supra,* at 627-628; Griswold, Note, 56 Harv. L. Rev. 1142 (1943).[81] Even where

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[79] Resp. Br. 5, 10-11. The Government also describes the net operating loss deduction as "a sharp departure from our established system of annual accounting periods." *Id.* at 11. See also *id.* at 5. Apparently this observation is designed to suggest that carry-backs and carry-overs are some sort of exotic exception in our income tax law. Actually the situation is quite different. Carry-backs and carry-overs are no more exceptional than any other well established deduction. They articulate a general and pervasive principle which governs the taxation of all business income.

[80] This Court has held that penal statutes, too, "should be given their fair meaning in accord with the evident intent of Congress." *United States* v. *Sullivan,* 332 U.S. 689, 693 (1948). See also *United States* v. *Brown,* 333 U.S. 18, 25 (1948); *Kordel* v. *United States,* 335 U.S. 345, 349 (1948).

[81] As tax rates continue to cut wide and deep, it is especially important that the tax base be confined to the taxpayer's true profit.

the deduction claimed is "an unexpected windfall," it "will not be withheld" if it "is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole." *Lewyt Corp.* v. *Commissioner, supra,* at 240.[82] The obligations of a taxpayer stem from the words used by Congress. Whether a disputed item involves gross income or a deduction, statutory interpretation is a good deal more than a mechanical resort to canons of construction. See Frankfurter, *Some Reflections on the Reading of Statutes,* 47 Col. L. Rev. 527, 544 (1947). "Indeed, nothing is so likely to lead us astray as an abject reliance upon canons of any sort; so much the whole history of verbal interpretation teaches, if it teaches anything." *Van Vranken* v. *Helvering,* 115 F. 2d 709, 711 (2d Cir. 1949), *cert. denied,* 313 U.S. 585 (1941).

In the felicitous phrasing of Judge Learned Hand, "interpretation is the art of proliferating a purpose which is meant to cover many occasions so that it shall be best realized upon the occasion in question." *Brooklyn Nat. Corp.* v. *Commissioner,* 157 F. 2d 450, 451 (2d Cir. 1946), *cert. denied,* 329 U.S. 733 (1946). See also *Universal Camera Corp.* v. *Labor Board,* 340 U.S. 474, 489 (1951). Here, we believe, the purpose of Congress is "best realized" by our reading of the statute. The resulting corporation in a statutory merger is "the taxpayer" for other purposes of the Internal Revenue Code, and no adequate reason has been given for reading section 122 differently. We fully agree with what the Government stated many years ago in a related context. If the resulting corporation "must bear all the burdens" of the component corporation, "it is likewise entitled to all the privileges of that corporation." G.C.M. 7310, *supra,* at 240. Our view has other virtues, too, which the Eighth Circuit's opinion lacks. It "safeguards

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[82] Cf. *Helvering* v. *Union Pacific Co.,* 293 U.S. 282, 284 (1934), which sustained a deduction in the absence of any statute "specifically authorizing" it.

the interests of the Government,[83] interprets a business transaction according to its tenor, and avoids gratuitous resentment in the relations between Treasury and taxpayer." *Rosenman* v. *United States, supra,* at 663.

CONCLUSION

The decision of the Court of Appeals is erroneous and should be reversed.

Respectfully submitted,

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[83] See discussion of section 129, *supra,* at pp. 45-50.

APPENDIX

BUREAU OF INTERNAL REVENUE

INCOME TAX UNIT

PENSION TRUST DIVISION INFORMATION SERVICE

PS No. 62 May 5, 1950

Section 23 (p)(1)(A)(iv)—Carry overs of Pension and Annuity Contributions in Excess of Allowable Deductions.

Section 29.23(p)-8—Contributions Under Pension and Annuity Plans in Excess of Limitations Under Section 23(p)(1)(A).

Internal Revenue Agents in Charge and Others Concerned:

Advice has been requested with respect to the application of the carry-over provisions of section 23(p)(1)(A)(iv) of the Internal Revenue Code, specifically in regard to deductions for contributions made by a predecessor company to fund past service credits under a pension plan which was subsequently taken over by a new company. The case in point is that of the M Company which paid $500,000.00 in 1947 to completely fund past service credits and deducted one-tenth, or $50,000.00 in each of the years 1947, 1948, and 1949, leaving a balance of $350,000.00 in 1949 when the corporation was liquidated and its business and all assets and liabilities were taken over, pursuant to a statutory merger, by the N Company which also assumed and continued the pension plan. The inquiry made is whether the balance of $350,000.00 will be allowable as a deduction to either company.

As to the M Company, having already deducted in 1949 $50,000.00, which is the "amount not in excess of 10 per centum of the cost which would be required to completely fund or purchase such pension or annuity credits as of the date when they are included in the plan" [section 23 (p)(1)(A)(iii)], there is nothing further that it may deduct in that year. Also, having been liquidated in 1949 there will be no occasion for further deductions.

As to the N Company, the problem involved is one to be resolved in accordance with the line of distinction to be drawn between *New Colonial Ice Company, Inc.* v. *Helvering*, (1934) 292 U.S. 435, and *Helvering* v. *Metropolitan Edison Company*, (1939) 306 U.S. 522. In *New Colonial Ice Company, Inc.* v. *Helvering, supra*, a new corporation was denied a deduction in respect of net operating losses previously sustained by another corporation the assets of which had been acquired, subject to liabilities, for stock of the successor, the old corporation being subsequently dissolved. In *Helvering* v. *Metropolitan Edison Company*, following mergers consummated pursuant to state law and in connection with which a parent corporation acquired the assets, subject to liabilities, of its subsidiaries the parent was allowed to deduct unamortized discount and expense on bonds issued by the subsidiaries prior to the mergers.

Accordingly, since the N Company acquired the assets of the M Company pursuant to a statutory merger which by operation of law effected a fusion of the assets and liabilities of the respective companies it is entitled to deductions in succeeding years, commencing with 1950, with respect to the balance of $350,000.00 to the same extent as the M Company would have been entitled had it continued in business.

Correspondence regarding this release should refer to the number and to the symbols IT:PS.

E. I. McLARNEY,
Deputy Commissioner.

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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1956.

LIBSON SHOPS, INC.,
Petitioner,

vs.

GUSTAVE F. KOEHLER, District Director
of Internal Revenue,
Respondent.

PETITION FOR REHEARING.

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INDEX.

	Page
Petition for rehearing	1-11
1. Certiorari and decision	2
a. Certiorari in the instant case	2
b. Certiorari in the related cases	4
2. The decision of the Court is based upon an erroneous premise	5
3. The decision and opinion in this case, if allowed to stand, will confuse the administration of the revenue laws	6

Cases Cited.

Gallo Winery v. Commissioner, 227 F. (2d) 699	2, 3
Le Tulle v. Scofield, 208 U. S. 415 (1940)	11
Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U. S. 462 (1933)	11
Stanton Brewery v. Commissioner, 176 F. (2d) 573	2
United States v. Koppers Co., Inc., 134 F. Supp. 290 (Ct. of Claims, 1955)	1, 4
United States v. Newmarket Manufacturing Company, 233 F. (2d) 492 (1st Cir., May 18, 1956)	1, 4

Statutes Cited.

I. R. C. 1939, Secs. 23 (s) and 122	2
I. R. C. 1939, Sec. 122	9
I. R. C. 1954, Sec. 172	9
I. R. C. 1954, Sec. 355	7
I. R. C. 1954, Sec. 381	3, 8
I. R. C. 1954, Sec. 382	9
I. R. C. 1954, Sec. 382 (a)	8, 9
I. R. C. 1954, Sec. 382 (b)	9
12 T. C. M. 415	3

Miscellaneous.

Business Week, June 1, 1957, p. 39 8
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IN THE

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GUSTAVE F. KOEHLER, District Director
of Internal Revenue,
Respondent.

PETITION FOR REHEARING.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Libson Shops, Inc., respectfully prays for a rehearing of the above cause, which was argued January 14, 1957, and decided May 27, 1957.

The grounds for the petition are as follows:

1. The case was decided upon a ground which was not fully argued, due to peculiar applications of the processes of certiorari in this case and in two related cases, **United States v. Newmarket Manufacturing Co.**, and **United States v. Koppers Co., Inc.**, October Term, 1956.

2. The decision is based upon an erroneous premise.

3. The decision and opinion, if allowed to stand, will confuse the administration of the revenue laws.

1. **Certiorari and Decision:**

The case was decided upon the ground that the income against which petitioner sought to offset the losses in question was not produced by substantially the same businesses which incurred the losses (Opinion, p. 8). This aspect of the case was not fully argued at the hearing on January 14, 1957, because of the peculiar manner in which the processes of review had been applied by this Court.

a. **Certiorari in the Instant Case.**

The question presented for review by petition filed April 14, 1956, was whether under the Internal Revenue Code of 1939 the surviving corporation in a statutory merger in computing its income tax for a period after the merger is entitled to carry over and deduct from its gross income net operating losses sustained prior to the merger by other merged corporations. This question was unsettled under the Internal Revenue Code of 1939 solely because the applicable statute provided that if for certain years "the taxpayer" had a loss, such loss should be a carry-over for succeeding years, but gave no indication whether the surviving corporation in a statutory merger was for this purpose to be deemed the same taxpayer as each of its merged component corporations. I. R. C. 1939, Secs. 23 (s) and 122.

At the time the petition was filed there existed a marked conflict in the opinions in the several circuits with respect to the "same taxpayer" question. On the one side were a Second Circuit decision in **Stanton Brewery v. Commissioner**, 176 F. (2d) 573, and a Ninth Circuit decision in **Gallo Winery v. Commissioner**, 227 F. (2d) 699, each of which had allowed the surviving corporation in a statutory merger to succeed to tax credits of its component because it was the same taxpayer. 176 F. (2d) 576; 227 F. (2d) 704 (Petition, p. 5). On the other side was the Eighth Circuit decision in the instant case which concluded that

the other cases were "not persuasive." 229 F. (2d) 220, 227.

Petitioner sought certiorari for this reason alone, as it appeared to be the only logical basis for granting the writ. Congress in the Internal Revenue Code of 1954 had permitted an acquiring corporation in a tax-free reorganization (specifically including a statutory merger) to "succeed to and take into account" net operating loss carry-overs among other items belonging to its transferor corporation. Internal Revenue Code of 1954, Section 381. The federal question involved had been solved by Congress for later years. In this view the Government concurred. (Br. for Resp. in Opposition, p. 10.)

Petitioner, in seeking certiorari and the respondent in opposing it, both recognized it was arguable that the cited decisions were not in conflict with the Eighth Circuit's decision in the instant case, as **not** turning upon the question whether the surviving corporation in a merger is the "same taxpayer" as each component, but as turning instead upon facts peculiar to those cases, e. g., the fact (or supposed fact[1]) that there was but a single business which produced both the loss and the profit which the taxpayer sought to offset (Petition, pp. 8-10; Br. for Resp. in Opp.;

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[1] *Gallo Winery v. Commissioner*, supra, involved more than one "business" in the narrow sense, and in this respect is identical with the present case. The Court of Appeals in that case omits to mention this fact, but it is shown in the Tax Court's findings of fact. 12 T. C. M. 415. It should be noted that the Government refrained from seeking certiorari in *Gallo Winery*, although, if any effect were to be given to the single business feature, the conflict between the *Libson Shops* and *Gallo Winery* decisions would appear to be more marked than that between the *Libson Shops* and the *Newmarket* or *Koppers* decisions, supra, in which the Government *did* seek certiorari. The Government in explaining its action pretended to be unaware of the fact similarity between *Gallo Winery* and *Libson Shops* (Br. for Resp. in Opp., p. 8) and notwithstanding your petitioner's citation of the Tax Court decision (Br. on Merits, p. 25) this Court in its opinion was apparently led into error by the misstatement of fact in respondent's brief.

pp. 7-8). As petitioner viewed the matter, if this Court were to accept this argument and conclude that the allegedly conflicting decisions turned upon the business concept and therefore were distinguishable, the Court might reasonably be expected to deny certiorari in the instant case; but when certiorari was granted on June 4, 1956, petitioner concluded that the Court recognized the existence of a conflict of circuits over the "same taxpayer" question, and, therefore, that this question was critical for purposes of argument on the merits. Both in brief and in oral argument, petitioner devoted the major portion of its analysis to the question whether the surviving corporation in a statutory merger is to be deemed the same taxpayer as each of the component corporations, and gave only scant consideration to the "same business" question.

b. **Certiorari in the Related Cases.**

On June 28, 1956, after certiorari in the instant case had been granted, the Government applied for certiorari in **United States v. Newmarket Manufacturing Company**, and in **United States v. Koppers Co., Inc.**, supra. Those cases, 233 F. (2d) 492 (1st Cir., May 18, 1956), and 134 F. Supp. 290 (Ct. of Claims, 1955), like **Libson Shops** involved the question of succession to a net operating loss tax credit in a statutory merger, but were like **Stanton Brewery** insofar as comparison of the businesses which produced the profits and losses was concerned. It was patently inconsistent for the Government in one breath to argue in **Libson Shops** that **Stanton Brewery** was distinguishable and in the next breath to argue in **Newmarket** and in **Koppers** that **Libson Shops** was sufficiently conflicting to warrant certiorari. Realizing its dilemma, the Government asked this Court to hold in abeyance disposition of its petitions pending decision on the merits in **Libson Shops**. This Court granted the request and failed to act upon the **Newmarket** and **Koppers** petitions until

June 3, 1957, one week after its decision in the instant case, and then denied the petitions. By so doing, this Court not only enabled the Government without embarrassment to persist in disputing the authority of the Second and Ninth Circuit cases as applied to the instant case, but further prejudiced your petitioner's position in this respect: If the Government's petitions had been acted upon and denied in regular course, your petitioner properly could have gained an additional insight into this Court's view of the significance of the varying facts of the several cases, and could have proceeded to brief and to argue the instant case accordingly, giving adequate treatment to the "same business" feature.

The processes of certiorari are admittedly unique. Implicit in them is the notion that they rest upon this Court's discretion. It is the rule of this Court, however, that its discretion shall be soundly and judicially exercised. Moreover, this Court has recognized that the granting of the writ properly establishes the issues. Thus, it frequently grants review of only one of several issues decided below, and it would have been improper for petitioner to urge issues expressly excluded in granting the writ. Petitioner submits that in view of these considerations it should be protected in having placed a reasonable construction upon the Court's action in granting certiorari, and against the consequences of the Court's extraordinary treatment of the Government's petitions in the related cases.

2. The Decision of the Court Is Based Upon an Erroneous Premise.

One of the principal reasons for this Court's decision is expressed in the opinion as follows:

> "In the present case, the sixteen sales corporations, prior to the merger, chose to file separate income tax returns rather than to pool their income and losses by

filing a consolidated return. . . . If petitioner is permitted to take a carry over, the sixteen sales businesses have acquired by merger an opportunity that they elected to forego when they chose not to file a consolidated return." Opinion, p. 7.

The decision is based upon error, for petitioner and the sixteen sales corporations, prior to the merger, had no right to file a consolidated return.[2] Section 141, Internal Revenue Code of 1939, requires, as a condition of such right, that there be a common parent corporation. As appears from the Record, page 2, and from the Court's opinion, page 1, the Libson corporations were not connected through stock ownership with a common parent corporation, although all of the stock of each was owned by the same individuals in the same proportions. Therefore, contrary to the Court's premise, the separate corporations had no opportunity to file a consolidated return prior to the merger in order to offset the losses of some against the profits of others. In view of the decision in this case, the consequence is that losses which at the time of the merger constituted potential tax benefits disappeared as a result of the merger, quite the contrary of the Court's belief that to allow the carry-over here would be to permit the merger to create tax benefits otherwise available only by election. (**Cf.** Opinion, p. 7.)

3. The Decision and Opinion in This Case, if Allowed to Stand, Will Confuse the Administration of the Revenue Laws.

The Court decided that the income against which the offset is claimed was not produced by substantially the same business which incurred the losses. The Court's conception of what constitutes a single business is in conflict

[2] The Court's error attracted immediate critical attention. See, for example, Research Institute of America, Taxation Report, p. 85 (June 6, 1957).

with the rule upon the same question in other aspects. Thus, the "spin-off" provisions of the 1954 Code (Section 355, I. R. C. 1954) allow the tax-free distribution of a separate business, but not of a part of one business. The regulations under Section 355, among examples of what constitutes a "trade or business," give the following:

> "Example (13). Corporation J has owned and operated a men's retail clothing store in the downtown area of the City of R for seven years and has also owned and operated a men's retail clothing store in the suburban area of the City of R for nine years. **The manager of each store directs its operations and makes the necessary purchases. No common warehouse is maintained.** Corporation J proposes to transfer the store building, fixtures, and inventory of the suburban store to a new corporation and distribute the stock of such new corporation to the shareholders of Corporation J. The activities of each store constitute a trade or business which has been in existence for more than five years." Regs. Sec. 1.355-1. (Emphasis supplied.)

It will be noted that in the example given the manager of each store directs its operations and makes its necessary purchases and no common warehouse is maintained. The implication is that in the absence of such facts, a number of retail stores, each dealing in the same product, constitute a single business. Such facts were absent in the instant case, since prior to the merger Libson Shops, Inc., was a management corporation (Record, p. 3) and as such vested with the customary central management functions of purchasing and warehousing.

The present decision will, therefore, create confusion in the application of Section 355 of the 1954 Code. It would tend to establish that on facts like those in the instant case business(es) could be split up, free of tax.

The decision likewise causes doubt and confusion in the provisions of the 1954 Code on carry-overs.

Thus Section 381 of the 1954 Code provides that in liquidations of subsidiaries and in tax-free reorganizations (including statutory mergers) the corporation acquiring the assets of another corporation shall succeed to net operating loss carry-overs, as well as other tax benefits of the transferor corporation. Both the statutory language and the committee reports have been thought to make it abundantly clear that the carry over is allowable on facts like those in the instant case. Yet this Court's decision, turning as it does upon the "one business" concept, casts a cloud of doubt[3] upon the effect of Section 381 and raises a serious question whether this Court has superimposed an extra-statutory requirement in order to qualify for the benefits of the new law.

In addition, the effect of the decision is to unsettle another section of the 1954 Code. Section 382 (a) provides that in the event of purchase of a corporation having net operating loss carry-over, the carry-over shall not be allowed if (i) there is a substantial change in stock ownership and if (ii) the corporation does not continue to carry on a trade or business "substantially the same" as that conducted before the change in stock ownership.

Under this statute, it had been reasoned that the start of a new business activity after the stock sale would not preclude the loss carry-over provided the old business were continued. See Prentice-Hall, Inc., Lawyers' Weekly Report, vol. 12, no. 36 (June 3, 1957). Indeed, this is the "continuity of business" which petitioner has urged as the only sense in which such continuity can be said to be necessary

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[3] See for example, commentary by Research Inst. of Amer., *op. cit., supra*, and Business Week, June 1, 1957, p. 39. The latter notes: "Internal Revenue officials say that *if the court means what it said* . . . the same principle will apply to all mergers under present tax law." (Emphasis supplied.)

under the 1939 Code. See Br. on Merits, p. 30; **cf.** Opinion, p. 6. This is also in accord with the underlying philosophy of the 1954 Code carry-over revisions as a whole. Congress, in Section 382, in effect states that where reorganization is involved, Congress' sole concern is with change in stock ownership, not at all with change in scope of business. **Compare** Sec. 382 (a) **with** Sec. 382 (b). See Reply Brief, p. 8. It will be remembered that there were no changes in stock ownership in the instant case (R., p. 3). Again, the effect of this Court's decision is to cast doubt upon the otherwise clear meaning of a federal tax statute and to open up whole new fields of controversy in derogation of Congress' manifest purpose to settle the law in this area.

Even more disturbing is the suggestion, implicit in the opinion, that notwithstanding the corporation seeking the benefit of a loss carry-over **itself** sustained the loss, it cannot avail itself of the loss by offsetting it against profits of a newly-acquired business. Heretofore, it has been the generally accepted view that the loss carry-over was allowable in these circumstances under the 1939 Code. See Research Inst. of Amer., Tax. Rep., p. 33 (Feb. 28, 1957). Hence no new legislation was enacted to cover the situation. The reasoning has been that in such a case the corporation seeking to utilize the tax credit is without question entitled to the benefit of the loss since it is the taxpaying entity which sustained the loss. I. R. C. 1939, Sec. 122; I. R. C. 1954, Sec. 172.

Under the present decision, however, even this result is controverted. For if Libson Shops, Inc., is not entitled to the carry-over, **whether or not** it is the same taxpayer as the merged loss corporations, "since the income against which the offset is claimed was not produced by substantially the same businesses which incurred the losses", it follows that the same should be true where the corporation seeking the credit had the loss. While the Court (without attempted distinction) disclaims any intention to pass on

situations where only one corporation is involved (Opinion, p. 8, n. 9), the case of merger of a corporation with profits into a corporation with losses does not seem to be distinguishable from the instant case on any reasoning of the Court. This situation is not governed by the special carry-over provisions of the 1954 Code and continues to be governed by the same considerations as were in effect under the 1939 Code. No court has ever held that the surviving loss corporation cannot carry over the loss and offset it against rights attributable to a business acquired from a merged corporation, and taxpayers and tax collectors alike have been governed accordingly. Yet in the face of the Court's decision in this case, no reason appears for continuing to permit the benefit in the case described any more than in the Libson Shops situation, and the absurdity now arises that if the loss corporation survives, the credit is not allowable, but if it does not, the credit may be enjoyed. Conversely, there is no logic in refusing the benefit in the instant case if it is properly allowable in the other case. See Br. on Merits, p. 33. At no point in the opinion does the Court address itself to this critical argument.

The Court's reasoning further suggests, contrary to the established rule, that in order for a tax-free reorganization to exist, there need not be continuity of business enterprise. The merger in which petitioner was the surviving corporation was, concededly, a code reorganization. No reason has ever been suggested why the identity of business enterprise required to sustain a reorganization ought to be less than that required to justify the carry-over here involved. The Court seems, therefore, to have inadvertently contradicted a proposition thought to be settled long ago, that continuity of business or interest is required to constitute a statutory merger a reorganization. Such continuity has been required in the past to constitute other types of exchanges reorganizations. It is

not reasonable to suppose the Court intended a distinction between statutory mergers and consolidations, on the one hand, and other reorganization exchanges on the other. Here, the Court dealt with a reorganization in a statutory merger, yet concluded it lacked continuity of business. A reorganization without continuity is a startling reintroduction of the formulas thought set at rest in such cases as **Pinellas Ice & Cold Storage Co. v. Commissioner**, 287 U. S. 462 (1933), and **Le Tulle v. Scofield**, 308 U. S. 415 (1940).

The question of what is a single business, as contrasted to two or more businesses, is and remains an important question, having many ramifications, of which the foregoing are examples. That question was decided in this case without consideration of its importance.

Wherefore, your petitioner respectfully prays for a rehearing of the above cause.

Respectfully submitted,

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I, the undersigned, hereby certify that the foregoing Petition for Rehearing in **Libson Shops, Inc. v. Koehler**, No. 64, October Term, 1956, is presented in good faith and not for delay.

Henry C. Lowenhaupt.